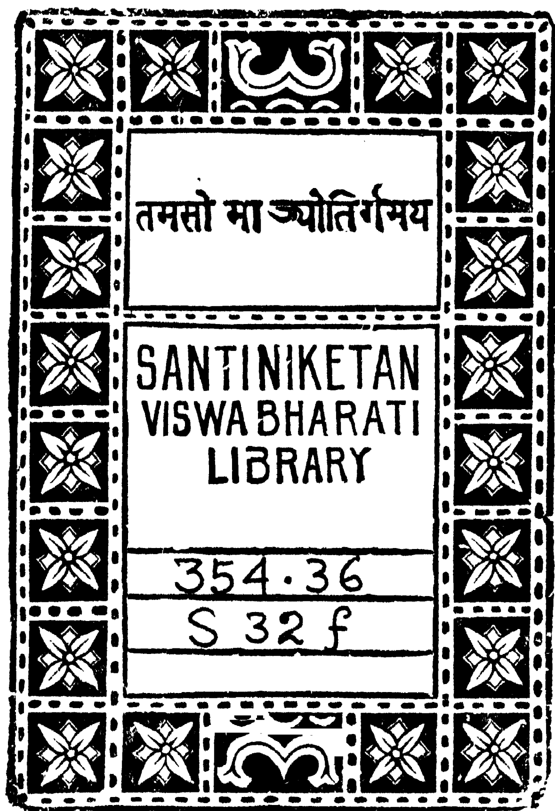

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THE BENAILLI READERSHIP LECTURES, PATNA UNIVERSITY.

FEDERAL FINANCE IN INDIA

BY

K. T. SHAH

Professor of Economics, University of Bombay.

D. B. TARAPOREVALA & SONS.

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A. G. M. D.

TO

MY FRIENDS

MAKANJI AND GULAB MEHTA

" You upset me, my dear. What, then, do you see in the eyes of your Models."

" Their dreams,—or, perhaps, mine."

(The *Rosary* French Version).

PREFACE.

These Lectures were delivered at Patna for the Benailli Readership of that University, for 1928-29. The subject chosen seems to the Lecturer to be one, which, at this juncture in our history, needs no special explanation or apology, greater than the one offered in the opening paragraphs of Lecture I.

Opportunity may, however, be taken of this Preface to add one explanation, which nowhere occurs in the text specifically. The treatment of the subject has been general, avoiding all particular discussion of the finances, whether of particular States or Provinces; not because the latter do not deserve to be carefully studied, but because, from the point of view adopted by the Lecturer, a detailed study of the several cases would have added unduly to the size and scope of his work, even if such a course could have added materially to the value thereof. Detailed study of the finances in individual Provinces and States,—and even in their likely components if split up, or their possible combinations if confederated, for purposes of cultural harmony or administrative convenience,—will have to be carefully made before the financial problem of the Indian Federation can be declared to have been solved. In these Lectures, however, the Lecturer has confined himself to considering rather the general principles or guiding considerations, which should attend the practical study of individual cases, than specific consideration of each separate case, in the hope that the line adopted by him would be as serviceable, at this juncture at least, as the other method of treatment.

Lecture V tries to concentrate in one place the case of the Indian States in certain matters relating to finance and economics. The stand-point has been adopted of the Indian States, almost exclusively, partly because that stand-point seems to be scarcely ever considered with the attention it deserves; and partly also because, in themselves, the questions raised in that Lecture need much wider publicity and more open discussion. The governing ideal of an Indian nation, in a federated form, has, however, been nowhere abandoned, or modified. Hence the suggestion for the combination of the smaller States to form more comparable and equal units in the Commonwealth of India;

The Lectures were addressed to an audience of University students of all classes, and were intended to be of genera public utility, rather than as a piece of learned research. There is much, however, in these pages which the Lecturer hopes will be found to be new, at least from the point of view from which it is presented, if in nothing else. Comparative statistics, and learned analogies, have been, accordingly, kept under very modest proportions, so as not to scare away the ordinary student from a glance at the Lectures in book-form. The Lecturer trusts this course would add to the general utility of the Lectures, without materially diminishing such merit as they may possess as a contribution to our knowledge of Public Finance in general, and Indian Finance in particular.

Reconstructive suggestions have been attempted in the concluding Lecture; but they are unavoidably in a general form, being rough estimates rather even than close approximation. The main tendencies, however, of the developments in finance, as envisaged by the Lecturer, and according to the ideals held by him, are sufficiently stressed by the *pro-forma* statement of revenue and expenditure, to be suggestive, if not helpful.

The sources and authorities the Lecturer is indebted to have been freely acknowledged in the body of the Lectures. The material in connection with the Indian States was obtained by the Lecturer by the willing courtesy and sympathy of the Ministers in several States, too numerous to be particularised. Their contribution, however, has been too considerable not to be specifically, and gratefully, acknowledged, in this place.

University School of Economics and Sociology,

Bombay, 25th December, 1928.

K. T. S.

N.B.—Under the Notes and Instructions—(Part III of the Income Tax Manual)—16, Exemptions made by the Governor-General in Council, in exercise of the powers conferred by S. 60 of the Indian Income Tax Act, (6) exempts the interest on Indian Government securities held by Indian Chiefs and Princes, as the property of their States, from the Indian Income Tax: while by a Notification of the Finance Department, No. 25, dated 1st of July, 1926, the British Indian Income Tax is charged at half the usual rate on incomes on which both the British Indian and any State Income Tax have been levied. Cp. pp. 233-238. Among the Indian States maintaining a separate Post Office of their own, Travancore must be included.

FEDERAL FINANCE IN INDIA

(Being a Course of Six Lectures of the Benailli Reader of the Patna University for 1928-29, *delivered successively on the 5th, 6th, 7th, 8th, 9th, and the 10th November* 1928, *at Patna).*

LECTURE I.

General Principles of Federal Finance.

Mr. Horne, Students of the Patna University, Gentlemen,

I appreciate very much the privilege of addressing you as the Benailli Reader of your University for the current academic year; and my appreciation is the more deepened by the kind words in which Mr. Horne has introduced me. I shall, however, have occasion to thank you all, at the close of this series of Lectures, when my gratitude will perhaps sound more sincere than to-day; and so I shall postpone the expression of my appreciation of the privilege more fully to a later date. Before, however, I pass on to the subject of this evening, will you permit me to express my deep concern at any inconvenience that may have been caused to any of you by the date of the Lectures coinciding with the opening of the term, and perhaps also by the insufficiency of notice to the students and the public intending to be present on the occasion. The dates had been fixed upon months ago in consultation with your University; but these points of minute detai very likely did not attract the attention at the time of the parties concerned, and hence the inconvenience, if any.

The subject I have selected for this Series of Lectures for the Benailli Readership this year has, I venture to suggest, a peculiar fitness at the moment, and particularly in this city of Patna. This is, I need hardly tell you, the seat of India's most ancient and historical Empire, of an extent and importance second not even to the present British Empire in our land. Lacking in sufficient data on the point, it may, perhaps, be impossible for us at this time to dogmatise about the financial organisation and administration of the Mauryan Empire founded by Chandragupta, and raised to unfading renown by his pious as well as efficient grandson; though, for my part, I am inclined to believe that they in those days also must have had some kind of a federal financing in practice. The very nature of the Empire of ancient times, and of their economic organisation, must have rendered inevitable a degree of local autonomy in practice,-whatever the theory of imperial Government,-which must sound phenomenal in our days of increasing centralisation.

However that may have been in the past, I think the significance of this subject, and its high topical importance in the actual problems of government facing the Indian people to-day, will not be questioned by any one. A Royal Commission is enquiring, even while these Lectures are being delivered, into the constitutional arrangements for the future government of India. One of the most difficult points in the task before that body is the happy adjustment of smooth financial relations between the central Government of India, and of the several provinces that make up the Indian Empire. The question of financial relations between the Indian Government and its Provincial constituents has, indeed, attracted considerable attention in the past; and, as I shall endeavour to show to you in

a later Lecture, the evolution of financial decentralisation in India had, even before the Constitutional changes of 1919-20, proceeded very distinctly on the lines of a federal organisation. The existence, however, of the federal principle in Indian public finance has hardly ever been specifically and authoritatively recognised. In fact, it would not be too much to assert that the conscious aim has sometimes been to deny such a principle, whenever attention was drawn too pointedly to its operation in fact. The study of Indian Public Finance, therefore, in these Lectures, from a distinctly federal standpoint, will have, I trust, its own significance and utility at this juncture.

The moment of time is the more appropriate for such a study, since another Committee, presided over by Sir Harcourt Butler, is simultaneously enquiring into the relations between the Government of India and the Indian States. There is much in these relations and their conduct hitherto which is ambiguous and unsatisfactory. But nothing equals in ambiguity and want of satisfactoriness, the mystery that hangs round the fundamental question of principle to govern these relations in matters of finance. Are the Indian States an integral part of a Federation of India? The question is as vital as it is difficult to answer. I shall try and supply some material in a later Lecture to answer it. Meanwhile, will you permit me to add that the mere fact of this question being with us makes the Indian problem of financial adjustment exceedingly peculiar. There is nothing anywhere else in the world,-with the possible exception of old Germany, perhaps,-exactly to correspond to the complication created by the existence of the Indian States. This lends its own importance and interest to this subject at the present moment; and I hope you will find

much in these Lectures, which is, if not entirely new and original to those familiar with the problems of Indian Public Finance in general, at least highly suggestive.

Apart from these reasons peculiar to our country for the moment, my choice of the subject for these Lectures was also dictated, in part at least, by the realisation that the problem of *Federal Finance* as such has hardly ever been scientifically studied in a single treatise to my knowledge. Writers on public finance have, no doubt, alluded to the peculiarities of federal finance incidentally as the points cropped up in their general discussion. But their basic view-point seems to have been that of a unitary state, in which a federal organisation made a complication, often considered to be needless, and rarely discussed with the patience and fulness the steadily growing importance of the problem deserves. At the present moment, moreover, the problem of what is known as the incidence of "Double Taxation" has become of world-wide importance. More than one endeavour has already been made to find out some satisfactory solution for it. Apart, however, from the importance of "Double Taxation", as between the mutually independent states of the civilised world, the question has its own interest and complexity as between the parts of a federation; and, as I shall endeavour to show in the following Lectures, in India we have this complexity of our own in an ample measure, not only as between the British Provinces and the Government of India, but far more so as between British India and the Indian States.

The choice of the subject, then, may I take it, is sufficiently explained and accounted for. India has, obviously, her own peculiarities—so many and varied, that scarcely any known analogy

will fit her conditions at all points. As already observed, there is no parallel in the world exactly to the Indian States in relation to the Government of India; and that fact alone makes for a peculiarity, which invests the study of the question with its own interest and significance. The tradition and convention in regard to the financial relations between the central and the provincial governments in British India are, again, sufficiently *sui generis* to make the problem peculiar, even if the study is confined to British India only. And this, too, without the admixture of the purely local bodies, such as the Municipalities and District Boards, which raise their own difficulties in regard to the financial administration of the country at large. Given these peculiarities, the study of the question must necessarily be based, primarily, on Indian conditions and traditions. The analogy of other federations, within as well as without the British Empire, may have its use at points, no doubt; but the analogy cannot always be pressed to its logical conclusion, for reasons that in each instance it will not be impossible to understand. I shall, therefore, adopt the course, in these Lectures, of considering in outline the financial relations as between the principal federations now existing and their constituent states or provinces, in the First Lecture to-day; to be followed up, in the next Lecture, by a survey of the financial evolution in this country, with special reference to the principle of federalism. In the next two Lectures,—the Third and the Fourth,—I propose to examine in some detail the revenues and expenditure of the Government in British India, again from the standpoint of federal financing. Lecture V. will be devoted to a consideration of the financial relations as between the Government of India and the Indian States,-a somewhat lengthy process, which, I very much fear, will not be compressed

within the conventional time-space allotted to a Lecture. It may as well be mentioned, at this point in passing, that the time-limit will be impossible to observe, I fear, in any Lecture rigorously. The Lecturer trusts to your indulgence for permitting him to complete the task of each Lecture on the day allotted for it. In the last and the concluding Lecture, the ancillaries of public finance,—such as money and banking, currency and credit, audit and accounts,—will be reviewed briefly, followed, if time and your patience will permit, by some suggestions of the Lecturer's own for a readjustment of the relations, removing the difficulties noticed in the course of the Lectures.

One more word, and I shall have done with these introductory remarks, explaining the scope and the nature of the subject of these Lectures. The Lectures are styled, I understand, the series of the Benailli Readership. You may, however, find that though I am styled a Reader, I shall not be "reading" any part of these discourses. For one thing, I very much fear your interest in this somewhat complex subject may not be sustained, were the "Reader" to be reading out of a manuscript copy of the Lectures. But though I may not literally read out, I assure you I shall follow the main argument rigorously enough not to admit of any serious discrepancy between the Lectures as delivered, and the same as you will find them when printed and published. As, moreover, the Lectures are to be printed and published, I shall leave out the additional complications of detailed statistics, which will, of course, appear in the printed Lectures; but which will, in the discourses as delivered, be laid before you in round terms. These conditions will, I trust, make the Lectures easier to follow; while they will have all the paraphernalia of learned discourses, if I may use the term, when they appear in book-form.

The distinguishing marks of a federal organisation consist in a division of Sovereignty between the constituent States making up the Federation and the Federation itself. Almost all the existing federations in the world to-day,—with the possible exception of the United States of Brazil, and the Indian Empire,—have been brought about by a kind of compact between the constituent states existing before their federation into a new state; and this agreement has led to a distribution of powers and functions as between the constituent States and the Federation, in accordance with the impulse which led them to unite. According as the federating impulse was powerful or otherwise, the powers of the associates and of their association have varied; and the financial resources placed at the disposal of either have had to correspond to the functions and obligations assigned, respectively, to the Union and to the uniting states. There is, naturally, no uniform model for the several federations of the world to conform to. Each has to evolve its own system according to the urge which makes for the union, in the first instance; and each has, likewise, to effect its own modifications in the course of its history which the exigencies of the age and the country demand. Subject to this limitation, it may, however, be said, that in general, in all federal states, the functions of National Defence and maintenance of National Credit, at home and abroad,—together with all those other matters which concern more than one province or the nation's welfare collectively,—are entrusted to the Union Government; while all matters primarily of local interest and concern are left to the federating states, or their delegates. The subjoined summary of the division of powers and functions, as between the leading federations and their member states, is appended by way of illustration and confirmation of the foregoing remarks:—

II. Review of the Constitutional Position affecting Finance in the Leading Federations.

In the United States of America, whose federal republican constitution is now the oldest in the world, section VIII of the Constitution of September, 1787, allows the Congress power to levy and collect taxes and imposts, to pay for the debt and provide fcr the common defence and welfare of the Union. The taxes and duties, however, voted by the Union Legislature, must be "uniform throughout the States." Money may be borrowed by the same body on the credit of the United States, and the foreign as well as the internal trade of the Union regulated. Nationalisation of aliens and laws governing bankruptcies are likewise within the province of the Congress, as also coining of money, regulation of currency, and fixing of weights and measures. Establishment of the Post Office and Post roads is a Union subject, as also the guaranteeing to authors or inventors the copyright or patent in their works or discoveries. All courts of law, below the Supreme Court established by the Constitution, may be set up by the Congress; and the same authority may define and punish piracies and other offences on the High Seas. The declaration of War, maintenance of internal order, raising and maintaining of an army and navy, and making of rules for the governance and regulation of the land and sea forces, are all vested in the same body.

These are considerable powers; and though the Constitution has been amended over and over again in the hundred and forty-one years since its adoption, the powers of the Central Government have been more often increased than not. The original Constitution had prohibited to the Congress any interference with the right of the States to regulate migration; and an interdict was placed upon any suspension of the writ of *Habeas Corpus*,

except in extraordinary emergencies of rebellion or invasion. It was equally clear and positive about direct taxation :—

> "No capitation or other direct tax shall be laid, unless in proportion to the census or enumeration herein before directed to be taken. No tax or duty shall be laid on articles exported from any state. No preference shall be given by any regulation of commerce to the ports of one state over those of another ; nor shall vessels bound to or from one state be obliged to enter, clear, or pay duties in another."

The part of this section IX relating to the prohibition of direct taxation to the Union Government caused increasing embarrassment to the Central authority, as the obligations and requirements of that authority began to expand ; and so the portion was amended. after a historic struggle, by the **Amendment Sixteen** of the Constitution adopted in 1913 :—

> "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

This does not include taxation of property, which is even now the monopoly of the states making up the Union.

The powers of the Constituent States, however, comprise all the field that is not specifically assigned to the Union. Amendment X of the Constitution, adopted as early as 1791, lays down:—

> "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively or to the people."

The only powers expressly prohibited by the constitution to the States include dealings with foreign States, coining money or emitting bills of credit, passing any bill of attainder or granting titles of nobility, or making laws impairing the obligation of contracts. Levying of duties on imports or

exports, without the consent of the Congress, is similarly forbidden to the States, except for what may suffice for their inspection laws; and all monies collected from such duties must go to the United States Treasury. On the same analogy, and under the same limitation, keeping of troops or warships in time of peace, or engaging in war, or making warlike alliances with foreign states is forbidden to the States, "unless actually invaded, or in such imminent danger as will not admit of delay." (Section X).

Financial obligations and resources in the Union have been divided in accordance with the governing principles of the federal organisation herebefore outlined. We shall review these financial relations in a minute. Let us here add, by way of contrast or comparison, the analogous provisions of the Swiss Constitution, which breathes the same air of local autonomy tempered with national cohesion. If the original Constitution of the United States is nearly 150 years old, the Swiss Confederacy dates in effect from the Middle Ages. The latest constitution, however, of this ancient mountain democracy dates from 1874, and embodies the experience of centuries of that people's own history. Local Autonomy is definitely the principal aim of the Swiss Constitution, even as in the days when Freeman wrote,—the confederation being formed and maintained as a useful adjunct to promote the common welfare.

> "*Les Cantons sont souverains en tant que leur souveraineté n'est pas limité par la Constitution fédéral, et, comme tels, ils exercent tous les droits qui ne sont pass délégués au pouvoir fédéral.*"

says article 3 of this Constitution. The powers of making war and peace are delegated to the Confederation, as also that of making treaties with foreign powers, including those regulating commerce. (Art. 8). But the Swiss Constitution is probably unique in its anxiety to maintain local rights,—in its reserving to the Cantons the right to conclude treaties with foreign states under exceptional conditions, on matters concerning public economy, neighbourly amenities, or police regulations,—provided that such Treaties contain nothing repugnant to the Federation or to the other cantons. (Art. 9). Among themselves, of course, the Cantons have the right to make conventions regarding legislation, administration of justice, on conditions that the same are intimated to the central authority, and that the latter finds in them nothing injurious to the rights of the other Cantons. The Army and provision for National Defence, even in this permanently neutralised country, belong to the Federal authority. Any Canton may have, besides its *gendarmerie,* upto 300 men of the permanent army (Art. 13. cp. also Art. 19). The Federation can order expropriation for certain purposes, subject to the payment of an indemnity or compensation. The supervision of the Forest Police, the regulation of fishing and hunting (25), legislation on Railways, Posts and Telegraphs (36), creation of a Federal University and provision for higher education, public debt and coinage of money and note-issue, fixing of Customs duties,—all these belong to the Federal authority. The revenue from the posts and the powder monopoly is reserved to the Federation; and that from Customs is similarly assigned, subject to certain refunds to specified Cantons. The constitutional provision in article 29 (2), while permitting Export Duties, requires them to be as moderate as possible. Certain duties in the nature of terminal taxes or *Octroi* on articles of

consumption within a Canton were, upto 1890 reserved to the Cantons. It is curious to note that, in Switzerland, the central authority has no right to make a monopoly of the issue of paper-money, nor to make such money legal tender. (39) As in the U.S.A., so in Switzerland, laws governing civil capacity, commercial transactions, literary and artistic property (copy right), and bankruptcy belong to the federal sphere (64).

The financial resources of the Swiss confederation, enumerated in article 42, include:—(1) the yield of the federal domain; (2) of the fedefal customs duties collected at the Swiss frontiers; (3) of the Posts and Telegraphs; (4) of the Powder monopoly; (5) half of the tax on exemption from military duty; (6) Cantonal contributions. Direct taxation is still reserved, in Switzerland, as it was in the German Empire before the War, to the Cantons.

The Post-war German Constitution leans as much on the side of the central or federal authority as the Bismarckian Empire leant on the side of the constituent States. The Federal Government is now given *sole* authority in regard to : Foreign and Colonial Affairs ; Nationality, Settlement, Immigration and Emigration, Extradition ; organisation of the Defence Force ; Coinage; Customs, and Internal Trade Regulation ; and the Postal services, including Telegraphs and Telephones. (Art. 6). On all matters concerning public peace, on which there is no need for uniform regulation, the Federation may legislate (9) ; while it may lay down the general principles—the so-called normative laws—for the guidance of local legislation in regard to :—the rights and duties of religious bodies; public

education including the Universities and scientific libraries; status of public corporations officials; land-laws, including the distribution of and settlement on lands, and their tying-up; housing and the distribution of population ; and the disposal of the dead. (10) On 20 specified heads, the federation has legislative authority concurrent with the States, e.g. Civil and Criminal Law and Legal Procedure ; Passports and Surveillance of Foreigners and provision for Poor Law and travellers ; the Press and Population, including Maternity and Child Welfare, Protection of Children and Young Persons; Public Health and Veterinary department; Labour laws, Insurance, Protection of Workmen and Labour Bureaux ; Expropriation and Socialisation of Natural Resources or Economic Undertakings ; Trade, Weights and Measures, Paper-Money, Banking and Exchange ; Traffic in Food-stuffs and articles of general consumption ; Industry, Mining and Insurance, High Sea Navigation, Deep Sea and Coastal Fishing ; Railways, Inland Navigation and Road Transport ; Theatres and Cinemas (art. 7). The guiding principle, however, in regard to such concurrent legislation is laid down in Article 13 : "*Federal Law overrides* (*lit. breaks*) *State Law.*" The preceding Article is reminiscent of the old preponderance of State rights as against the Federation :—

> "So long and in so far as the Federation has not exercised its legislative powers, the States continue free to legislate. This does not hold good of subjects as to which the Federation has sole power to legislate."

The financial resources, moreover, of the States have been drastically cut down by the Constitution of 1919.

> "The Federation may legislate as regards taxes and other sources of revenue, in so far as they are claimed, either wholly or in part, for federal purposes. When claiming taxes or other sources of revenue which hitherto belonged to the States, the Federation must have due regard to preserve the vitality of the States." (art. 8).

In regard to the management of the public credit, the present German Constitution makes a noteworthy improvement by Article 87, which may well be copied by other countries:—

> "Monies may be raised upon credit for extraordinary needs only, and, as a rule, only for productive expenditure. A federal law alone can authorise such raising of monies or the assumption, by the Federation, of liability by way of guarantee."

In contrast with these American and European models, the Federations within the British Empire,-in America, Australia and Africa,—manifest certain significant differences *inter se*, as well as in comparison with the non-British models. The following tabular summary of the Federal and State powers in the three principal British Federations will be instructive by itself:—

DOMINION OF CANADA:
Founded in 1867:

Distribution of Power between:—

The Dominion.

To make laws for the peace, order and good Government of Canada; particularly on:—

1 Public Debt and Property.
2 Regulation of Trade and commerce.
3 Raising money by taxation.
4 Borrowing money.
5 Postal Service.
6 Census and statistics.
7 Militia-Military and Naval Service and Defence.
8 Fixing emoluments of Canadian Government Officers.
9 Beacons, buoys.
10 Navigation and Shipping.
11 Quarantine.
12 Sea Coast and Inland fishery.
13 International and Interprovincial Ferries.
14 Currency and Coinage.
15 Banking and Paper money.
16 Savings Banks.
17 Weights and measures.
18 Bills of exchange and pro-notes.
19 Interest.
20 Legal Tender.
21 Bankruptcy.
22 Patents.
23 Copyright.
24 *Indians.*
25 Naturalisation.
26 Marriage and Divorce.
27 Criminal Law.
28 Penitentiaries.
29 Others.

The Provinces.

1 Amendment of provincial constitution.
2 *Direct Taxation* for provincial revenue.
3 Borrowing on provincial credit.
4 Provincial offices and officers.
5 Management of public lands in the Province.
6 Provincial Prisons.
7 Hospitals, asylums and charities.
8 Municipalities.
9 Trading licenses for revenue.
10 Local works and undertakings.
11 Incorporation of Companies with Provincial objects.
12 Solemnization of Marriage.
13 Property and Civil rights.
14 Judicial administration.
15 Punishment for enforcing Provincial laws.

COMMONWEALTH OF AUSTRALIA.

Founded in 1900.

Powers of—

The Commonwealth.

To make laws for the peace, order and good Government with respect to :—

1 Trade and commerce.
2 Taxation.
3 Bounties-uniform.
4 Borrowing.
5 Postal Services.
6 Commonwealth defence.
7 Lighthouses Defence, etc.
8 Meteorological observation.
9 Quarantine.
10 Fisheries.
11 Census and statistics.
12 Currency, coinage and Legal Tender.
13 Banking.
14 Insurance.
15 Weights and measures.
16 Negotiable Instruments.
17 Bankruptcy.
18 Copyright and Patents.
19 Naturalisation.
20 Foreign companies.
21 Marriage.
22 Divorce and Children.
23 Invalid and old age Pensions.
24 Service of processes and execution of judgments.
25 Recognition of State laws and judgments.
26 Special laws for aliens.
27 Immigration and Emigration.
28 Influx of Criminals.
29 External affairs.
30 Relations with Pacific Islands.
31 Acquisition of property.
32 Control of Railways for military Transport.
33 Acquisition of Railways
34 Construction of Railways
35 Conciliation and Arbitration.
36 Matters provided for by constitution during Transition.
37 References from State Parliaments.
38 Subjects on which only British Parliament could legislate.
39 Incidental matters.

The States.

Sec. 107 of the Commonwealth Act provides :—

"Every Power of the Parliament of a colony which has become or becomes a State, shall, unless it is by this constitution exclusively vested in the Parliament of the Commonwealth, or withdrawn from the Parliament of the State, continue as at the establishment of the commonwealth, or as at the admission or establishment of the state, as the case may be."

Sec. 109 says :—

"When a law of a State is inconsistent with a law of the commonwealth, the latter shall prevail and the former to the extent of the inconsistency, shall be invalid."

UNION OF SOUTH AFRICA.

Founded in 1909.

Powers of—

The Union.

Sec. 59 of the Act says :—

"Parliament shall have full power to make laws for the peace, order and good Government of the Union."

(There is no more particularisation of this plenary jurisdiction).

Sec. 86 amplifies the Union Parliament's powers by limiting the powers of the provincial Parliament.

"Any ordinance made by a provincial Council shall have effect in and for the province as long and as far only as it is not repugnant to any Act of Parliament."

The Provinces.

Sec. 85 of the Act enumerates the powers of the provincial Legislature :—

1 Direct taxation in the Province.
2 Borrowing on provincial credit subject to consent of Governor—General.
3 Education—(not higher.)
4 Agriculture.
5 Hospitals and charitable institutions.
6 Municipalities, etc.
7 Local works—not railways harbours.
8 Roads and Bridges.
9 Markets and Pounds.
10 Fish and Game preservation.
11 Punishment for enforcing provincial laws.
12 Other local matters.
13 Matters delegated by an Act of Parliament.

Financial Provisions in Federal Constitutions.

The varying magnitude of the powers of the Federal and of the State or provincial authority, respectively, in each case reflects the varying force of the urge for union. The same is reflected more materially in the financial provisions of these constitutions, or the conventions that have grown up thereunder. In the oldest and the most considerable Federation of our times,—the United States of America,—the Union Government was expressly denied, for a century and a quarter after its creation, the right to levy direct taxes. The Sixteenth Amendment of the Constitution has changed this state of things since the last

fifteen years; and direct tax-receipts now form as integral and important a part of the Federal Budget in the United States as in any other country. But the dread of the champions of the local sentiment is evident in the present Swiss Constitution,—as it was remarkable in the pre-war German Constitution,—in the rigorous refusal of direct taxation to the federal government. The present German Constitution allows direct taxes to the Central Government; and to that extent the forces of the Union seem to have been intensified as the result of the War. But even in Germany, the Reich Government has to make a refund to the States Governments of a part of these Direct Taxes surrendered by the latter to the former in the moment of dire national necessity. The subjoined comparative statements of the financial resources and obligations in the leading federations of the world, British as well as non-British, will serve to give a more concrete idea of the apportionment of the financial strength to the obligation placed upon each authority in a federation. There are certain common features which we shall emphasise a little more later on, and a few distinctive marks which set apart one federation from another, even as one country is distinguished from another.

Let us take the case of the United States first, as the most considerable financial illustration or our purpose. The latest Budget of the United States Government is given in some detail on pp. 18-19. From that you will perceive that the taxes and other sources of revenue placed at the disposal of the Union are in conformity with the powers and functions entrusted to the Union Government by the constitution.

Revenue and Expenditure of the United States 1926-27.

REVENUE.

	$
Customs	605,499,983
INTERNAL REVENUE.	
Income-Tax	2,224,992,800
Miscellaneous	644,421,542
OTHER RECEIPTS.—	
Government Securities	
Principal	45,699,573
Interest	160,389,600
Railroad Securities	89,737,959
All other Securities	63,474,987
Trust Fund Receipts (reappropriated for investment)	48,176,631
Sale of Surplus Property	18,068,530
Panama Canal Tolls, etc.	25,768,390
Miscellaneous	14,361,494
Receipts credited direct to appropriation.	
Other Miscellaneous	188,502,952
Total Ordinary Receipts * ..	4,129,394,441

* The terms Ordinary Revenue and Ordinary Expenditure are used to denote that the Post Office receipts and disbursements are excluded. The Minus item on the Expenditure side represents excess of credits to be deducted.

Revenue and Expenditure of the United States 1926-27.

EXPENDITURE.

	$
ıVIL ESTABLISHMENT.—	
Legislative	19,678,325
Executive	612,198
Department of State	16,497,669
Treasury Department	151,560,334
War Department	360,808,777
Navy Department	318,909,096
Interior Department	302,706,745
Post Office Department	189,038
Agriculture Department	156,287,30
Commerce Department	30,939,7
Labour Department	9,921,644
Justice Department	24,819,058
Independent Bureaux	35,442,771
Columbia District	37,566,521
PUBLIC DEBT CHARGES.—	
Sinking Fund	333,528,400
Foreign Repayment	159,961,800
Interest	787,019,578
Postal Deficit	27,263,191
Panama Canal	8,305,345
War Finance Corporation	*27,065,782*
Shipping Board	19,011,397
All others	719,621,361
Total Expenditure charged to Ordinary revenue.*	3,493,584,519

The Income of the several States in the Union is derived in a very large proportion from a General Property Tax, charged on real as well as personal property, and serving as the basis of income both for the State Government and also for the municipalities and county governing bodies. The aggregate revenues of the several States in 1926-27 amounted to $ 2078.536 million and the aggregate expenditure to $ 1936.195 millions.*

The States. it may be observed in passing, are not all of the same size, population, or wealth, inter se. Hence if we were to consider their *per capita* revenue or expenditure, we should get quite a disproportionate and misleading idea of the State Finance in the Union. Before the establishment of the United States, each constituent State used to levy its own Customs duties, had its own system of Excise duties, and a General Property Tax. The new Constitution took away the Customs duties from the States; and though the Excise and General Property Tax Revenues were left to the States, reliance was mostly placed by the latter on the last source to eke out their Budgets. In the eighteenth century, and for some time in the nineteenth, this tax satisfied all the requirements of a productive, convenient, and easy source of revenue. Property was then mostly in the form of land or houses, which could not easily evade taxation, even if the tax-payer so desired. With the growth, however, of personal, moveable property, especially in the form of industrial or governmental securities in the nineteenth century, the old attraction of the General Property Tax disappeared; and the States were hard put to it to devise methods and machinery which

* Compiled from the Statesman's Year Book, 1928. The States include also Alaska, Hawaii, Porto Rico, and Philippine Islands; but no figures are available for the Virginia Islands Samoa Islands and Guam.

would prevent tax-evasion, as also to discover additional supplementary sources of Revenue. Assessments had to be revised, standardised, and made to follow definite scientific rules ; while the administration of the assessment department came gradually to be handed over to the central tax authorities, to prevent fraud, mistake, or evasion. New taxes discovered to supplement the State resources naturally took the form most suitable to the peculiar industrial or commercial organisation and development of each State. Thus the Corporation Tax became a prime favourite with all those states in which industrial development permitted such a source of income. The infinite variety of that tax, in recent years,—in its basis and method of assessment, its rate of taxation, its mechanism of collection,—has made it one of the wonders of the world taxation. Franchise Taxes, a peculiarity of America, also a handsome and a growing source of State revenues, may, scientifically speaking, well be regarded as only a variant of the Corporation Tax. But the trend to levy Income and Inheritance Taxes by the State Governments, beginning with Wisconsin in 1911, and now adopted among others, by the States of Massachussetts and New York, cannot be so lightly passed over ; since it is bound to create complexities of double taxation and excessive burdens, which, in the British Commonwealth of Nations has already become a sore point of Imperial Tax administration. Says a close student of the state governance in the United States :—

> "These income taxes are assessed and collected under the direction of the central tax authorities, and the proceeds are generally reserved for the use of the States : but in Massachussetts, New York and Wisconsin, a distribution is made between the State and the localities." *

---

*Holcombe's *State Government in the United States*. On this subject the literature available is not as exten-

The *inheritance tax*, adopted in all except the three states of Alabama, Florida, and Nevada, is a growing source of State revenue, usually not shared with the local bodies within the State. The Motor Vehicle License Duty is another growing source of State income in all states; and the petrol tax obtains in forty-four states at varying rates.

The general position of the State Revenues and expenditure is well indicated in the following tables compiled from the authority already named.†

STATE REVENUE 1924.

TAXES.—	$	Per cent of Total.
General Property Tax	351.60	25.7
Special Taxes ..	226.77	16.6
Poll Taxes ..	3.62	0.3
Business and non-business Licenses	435.46	31.8
Special Assessments	23.86	1.7
Fines, Forfeits, escheats	8.04	0.6
Subventions, Grants, Donations, Pension Assessment ..	133.59	9.8
Highway privileges, Rents, Interest .	61.47	4.5
Earnings of General Department ..	113.04	8.3
Earnings of Public Service Enterprises	12.57	0.9

PER CAPITAL EXPENDITURE 1924.

	$
Highways	4.31
Education	3.68
Charities, Hospitals and correction	1.8
Miscellaneous	1.2
General Government ..	0.74
Development of conservation of natural resources	0.53
Protection to Person and Property	0.49
Health and Sanitation ..	0.23
Public Service enterprises	0.13
Recreation	0.04
Total ..	13.10

sive as might be wished for. The recent American writers—H. L. Lutz : *Public Finance* and J. P. Jensen : *Problems of Public Finance* (both NewYork,1924),—though writing primarily from the American standpoint for American readers, make very good reading in general principles. *The Proceedings of National Tax Conference*, 1919, seem to be far more promising, judging from the extracts. Mabel Newcomer's *Separation of States and Local Revenues* (1917), and Alzada Comstock's *State Taxation of Personal Incomes* (both in the **Columbia University Studies**) have each its own importance.

† Holcombe, Op. cit. p. 370 and 374.

It may be added that some states in the Union are allowed subsidies by the Federal Government, as these States themselves are too poor to be able to discharge, from their own purse, the minimum of State functions laid upon them.

In Germany, the Federal Budget consists of similar sources of revenue and expenditure as in the States. *

1927-28 (*Estimates*). (in Million Mks.)

REVENUE: ORDINARY.		EXPENDITURE.	
Taxes	6,860.0	Payments to States and communes	3,082.9
Customs	890.0	General Administration (including defence)	2,361.3
Fees	207.0	Unemployment Relief	610.0
Mint Profits ..	190.0	War and Civil Pensions	1,474.8
Surplus of previous years ..	200.0	Internal Charges from War (occupation) ..	198.2
Extraordinary:		Payments of Bonds and Reduction of Debt .	504.3
Loan	166.4	Dawes Payments ..	1,778.7
Railways ..	605.0		
Other Loans ..	590.9		
Total ..	10,010.2	Total ..	10,010.2

Comparing the actuals of 1913-14 with 1926-27, the figures are :—

(In Million Sterling).

	1913-14.	1926-27.
Total Ordinary Revenue ..	110.465 ..	247.050
Of these:		
Taxes on Property ..	16.265 ..	126.835
Traffic, Trade and Turnover Customs ..	36.090 ..	29.000
Excise and consumption Taxes	26.765 ..	71.780
Extraordinary Revenue	9.505 ..	0.045

EXPENDITURE.

	1913-14.	1926-27.
General Administration	27.000 ..	88.835
Army and Navy ..	103.100 ..	37.135
Expenditure due to War or Reparations	3.510 ..	121.125

The chief taxes levied by the federal German Government, with the yield in million marks of each in 1925-26, include: Income Tax (2170·0); Tax on wealth and Turnover (1686·0) Tax on capital transactions, comprising Company Tax, Securities Tax, Stock Exchange Tax and Director's Tax (103·0) ; Motor Vehicles (58·0); Stamp Duties on Bills (63·0); Traffic Tax (318·0); Tax on Bonds and Debentures (47·0); Customs (890.0); Tobacco (616·0), and Sugar (236·0) Tax: Spirit Monopoly (153·0), and Wine Tax (80.0); The yield is steadily growing; but the tax system of Post-war Germany cannot yet be said to have attained anything like permanence and definiteness.*

The resources of the States in Germany are, under the new dispensation, even more meagre than those in the United States. In the first years of the Bismarckian Empire, the component states of the Reich were expected to pay Matricular Contributions to balance the Imperial Budget, whose main prop was indirect taxation. With the change, however, in the fiscal policy of the Empire adopted in 1879, the Customs Duties grew so fast—in spite of a protective trend, that the federal Government was able to dispense with the States' contributions, even as the reviving prosperity enabled the Government of India to dispense with the Provincial contributions under the Montford Reforms. The War, however, and its legacy of heavy reparations to the ex-enemy nations, have so increased the burden on the federal Government, that they have taken up almost every important source of revenue from the constituent States, and materially added to the ingredients of the German Tax-system. The States, being deprived of their mainstay in revenue —Taxes on Income and Property—have to be compensated by the Federal Government, and hence

* *Post-war Germany* by the present writer.

the very considerable amount of expenditure by the central authority in respect of payments to the State funds. The total revenue of the constituent States in Germany from all sources amounted in 1926-27, to 1907·35 million marks, while the expenditure of the States aggregated 1926·32 million marks.*

The Swiss financial system is founded on the utter distrust of the federal authority in respect of direct taxation.†

The Federal Government is in charge of the Customs revenue which forms the bulk (85%) of the central income; proceeds of the Explosive monopoly which goes entirely to the

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* Compiled from the Statesman's Year-Book 1928. The financial year seems to vary in the different states, the figures given above being for the latest year in the 1928 Statesman's Year-Book.

† Information about Swiss institutions is exceedingly hard to obtain in English. The following quotations from the eminent students of Political Institutions will serve to explain the contention: Says Lord Bryce in his standard work on *Modern Democracies* :—

"The Swiss Tariff was till recently a low one, as compared with those of its great neighbours, and originally a tariff for revenue, and since the Federal Government did not *then* levy direct taxation" (Vol. I, p. 392).

The implication seems to be that now-a-days direct taxation is permitted. Lord Bryce's work was published in 1923. Prof. Munro in the *Governments of Europe* (1925) says of Switzerland :—

"The federal Government has control of the postal system. It operates the Swiss railroads (with a few minor exceptions); as well as the telegraph and telephone services. It has charge of the currency, and has the exclusive right to issue paper-money. It has control of banking, and has power to regulate commerce including the power to levy customs duties, *but it has no right to lay direct taxes upon the people.* If it needs more revenue than it can obtain from indirect sources, the federal government may levy upon the cantons in proportion to their wealth and taxable resources" (p. 700). Perhaps this last item justifies Lord Bryce's modification.

federal Government; and of the alcohol monopoly, which is distributed entirely among the Cantons, on condition that at least one-tenth of the amount received by the Cantons must be employed by them to combat alcoholism in its causes and effects. Exemption from military service is purchasable in Switzerland by paying a tax or indemnity to the State. But this is levied through the Cantons, and the proceeds are shared equally between the Cantons and the Federal Government. There are duties in the nature of customs duties levied by the cantons; but they are not to degenerate into transit duties of any sort. The mainstay of the Cantonal finance lies, besides direct taxation, in the federal subventions received by each. Lord Bryce has noted the current criticism of this item in these words: "The plan of granting subventions from the national treasury to the Cantons is alleged to be wasteful, injurious to the cantons in impairing self-helpfulness, and liable to be perverted for political purposes." (p. 411 op.cit.I.). The suggestion is that by means of these subventions, in the federal Government the dominant party may use undue pressure upon a smaller canton. But the fact is that under the convention obtaining in this behalf, a subsidy can be held up only if a canton fails to enforce a Federal law. Hence there is no positive harm likely to result to the essential independence of the Canton, which is greater in the Swiss federation than in any other similar organisation. The Budget subjoined is only by way of illustration.

The Budget Estimates (1928) *of the Swiss Confederation.*
(In francs.)

REVENUE.		EXPENDITURE.	
Capital invested ..	24,097,888	Debt Charge ..	112,752,800
General Administration	527,100	General Administration	5,134,187
DEPARTMENTS.—		DEPARTMENTS.—	
Political	193,050	Political	16,654,900
Interior	1,188,959	Interior	27,045,731
Justice and Police	2,188,500	Justice and Police	8,010,531
Military	1,692,435	Military	84,941,864
Finance and *Customs	282,101,970	Finance and Customs	21,304,229
Commerce, Industry and Agriculture	1,596,996	Commerce, Industry and Agriculture	58,501,812
Post and Railways	8,120,112	Posts and Railways	984,014
Miscellaneous ..	522,999	Miscellaneous ..	6,219,932
Total ..	322,230,000	Total ..	331,550,000

THE BRITISH DOMINIONS FEDERATIONS : AUSTRALIA.

The Budgets of the British Dominions Federation reflect similar tendencies at work, and for well-nigh the same reasons. The Commonwealth of Australia shows:—

* Compiled from Statesman's Year-Book 1928. The customs Revenue for 1926 amounted to 226,268,400, including 18,725,739 by way of tobacco dues.

1925-26.
(In Sterling.)

REVENUE.

	£
TAXATION.—	
Customs	27,839,889
Excise	11,353,989
Land Tax ..	2,521,910
Estate Duty ..	1,411,336
Income Tax ..	10,858,946
Entertainment Tax	460,[illegible]20
War-time Profits Tax *	77,491
Total ..	54,373,005
PUBLIC WORKS.—	
Postal etc. Services	10,771,756
Railways	349,768
Others	..
Total ..	11,121,524
OTHER REVENUES.—	
Interest, etc. ..	4.594,316
Coinage	332,014
Defence	130,662
Quarantine ..	30,553
Territories ..	41,973
Patents	42,017
Light-house ..	198,353
Pension Contribution	56,781
DEFENCE TRUST ACCOUNT.—	
Net Profit on Australian note-issue	1,048,062
Miscellaneous ..	316,516
Total ..	6,791,277
GRAND TOTAL ..	72,285,806

EXPENDITURE.

	£
COST OF DEPARTMENTS.—	
Governor General	29,928
Parliament ..	468,419
Prime Minister ..	944,379
Attorney General	185,427
Treasury . ..	9,640,409
Trade and Customs	1,541,864
Defence	4,004,827
Post-master General	10,651,925
Home and Territories	699,756
Works and Railways	1,811,098
Health	176,672
Markets and Migration ..	685,714
Total ..	30,841,418
MISCELLANEOUS.—	
New Works ..	316,941
War Services ..	30,171,850
Subsidies to States	7,951,727
INTEREST.—	
State Loan Act ..	2,084,757
Special Defence Provision ..	3,742,745
Total ..	44,109,438
GRAND TOTAL ..	75,109,438

* Compiled from the Australian Year-Book 1928. The Revenue in 1926-27 amounted, according to the Statesman's Year-Book, 1928, to £ 78,168,235 and ordinary expenditure to £ 75,532,638.

Amongst all the British Dominions, the Australian Commonwealth Budget is the most interesting, not only because of the intense activity of the State in those regions, but also because of the experiments in centralisation even now taking place there. Under the Constitution of the Commonwealth, S. 81, all revenues are to be paid into a general Consolidated Revenue Fund, while other monies are credited to special funds. Until the end of 1907-8, the balance of the Consolidated Revenue Fund, after the Commonwealth expenditure, was paid to the States. From 1907-8, until the abolition of the book-keeping provisions of the Constitution, the States received only three-fourths of the net Customs and Excise Revenue, and the balance of the Consolidated Revenue Fund was transferred to the Invalid and Old-age Pension Trust Account, and the Naval Defence Trust Account, to provide for expenditure in subsequent years.

At the present time, the financial relations between the several States and the Commonwealth are governed by special conventions, the substance of which is appended below.

Since the Commonwealth Government is levying direct as well as indirect taxes, the States needed funds for their own purposes, and they were paid annual subsidies. The amount of this subsidy was based upon an annual payment of £1 5s. per capita, with special concessions to Western Australia and Tasmania; and were in accordance with the provisions of the "Commonwealth Surplus Revenue Act" passed in 1910, for a period of ten years, subject to revision on the expiration thereof. This period expired on the 30th June, 1920; and it was then possible for Parliament to extend the Act for a further period, or to enter into new financial relations with the States. The "per capita" payments were conti-

nued provisionally up to 1927, when they were abolished as from June 30, 1927.

By the institution of the Federation, the several Australian States had to transfer to the Commonwealth their own revenues from Customs and the Post Office. For this sacrifice they were compensated, partly by the Commonwealth taking over the expenditure on Trade, Customs, the Post Office and Defence; and partly by the direct payment of the Commonwealth subsidy to the States on a population basis. This arrangement however, though it lasted for a considerable period, had its own defects and complications. Almost every year since the War, the Premiers' conference came to a deadlock because of the difficulty of raising and allocating the respective revenues of the States and the Commonwealth. At last, in 1927, the Commonwealth Parliament passed an Act, repealing the per capita payment to the States under the Act of 1910, and offering to pay the States on a population basis of any surplus revenues in the hands of the Commonwealth Treasurer on June 30, 1928, and of each year thereafter. For 1927-8, the payments under the Act of 1910 would be continued. By agreement between the States and the Commonwealth, economies have been effected in the tax-collecting machinery, as the same set of officers collect both the State and the Commonwealth Taxes in each state. The Commonwealth also offered, in 1927, to relieve the states of their heavy load of indebtedness, agreeing to pay the interest on these debts from the Commonwealth funds, and also to make adequate provision by way of sinking fund. All material points at issue were finally settled by agreement at a conference of Premiers in June-July 1927, which provided :—

The Commonwealth takes over, from July 1, 1928, all state debts existing on June 30, 1927, and contributes £ 7,584, 912 a year for 58 years towards interest charges on the same.

The Commonwealth contributes 2s. 6. per cent., per year, towards a sinking fund to relinquish existing debts in 58 years.

The Commonwealth contributes 5s. per cent. per year, towards a sinking fund to relinquish all future State debts raised after 1st July, 1927, within 53 years.

The Commonwealth shall arrange all future borrowing on behalf of the Commonwealth and the States, according to the decisions of the Loan Council, which shall be composed of representatives of the Commonwealth and all the State Governments.

The Commonwealth in full payment of transferred properties, shall take over State debts,bearing interest at 5 per cent. to the value of £11,036.000.

Steps are now being taken to have the agreement ratified by the Commonwealth and State Parliaments.

A temporary agreement embodying the above features is to be made between the Commonwealth and States for the period 1st July, 1927, to 30th June, 1929,

The subjoined table gives an idea of the States (consolidated) Revenue and Expenditure in Australia. (1925-26.)

REVENUE.	£	EXPENDITURE.	£
Taxation ..	23,452,704	Public Debt ..	28,191,145
Public Works and Services..	57,285,057	Railways and Tramways ..	39,176,752
Land. ..	4,929,259	Justice, Police and Prisons ..	4,713,986
Subsidy ..	7,624,099	Education ..	9,578,325
Miscellaneous ..	8,127,134	Medical and Charities ..	5,210,327
		Miscellaneous ..	16,724,300
Total ..	101,418,247	Total ..	103,594,835

The State taxes, it may be added, include Probate and Succession Duties, Land Revenue and Income Tax, License Duties, Stamp Duties ond Miscellanes.

* Official year Book Commonwealth of Australia pages 998-999.

UNION OF SOUTH AFRICA (FEDERAL FINANCE) 1923-24,

In the Union of South Africa; where the powers of the constituent provinces seem to be the least considerable, the Budget of the Federation is as follows:—

REVENUE ITEMS.	Amount in Million £. 1923-24. £	1927-28. £
Customs	6.670	7.985
Excise	1.945	1.932
Mining Revenue	2.109	1.650
Licenses : Trading and Professional	0.117	0.160
Stamp Duties and Fees.. ..	0.827	0.870
Income-Tax	5.408	6.522
Excess Profits Tax	0.027	
Estate and Succession duty ..	0.441	0.550
Native Taxes	0.898	0.900
Pass Fees..	0.037	0.050
Land Revenue	0.173	0.130
Forest Revenue	0.077	0.090
Rents of Government Property	0.186	0.210
Interest	1.068	1.550
Departmental Receipts ..	0.581	0.700

EXPENDITURE.	Amount. 1923-24. £	1927-28. £
General Government	3.178	8.352
Law, Order and Protection ..	5.270	8.352
Higher Education, Science, etc..	0.366	0.955
Public Health, Medical, Lepers and Mental Disorders ..	0.785	0.932
Lands and Agriculture	1.672	1.472
Mines and Industries	0.380	0.391
Public Works	0.775	0.938
Posts, Telegraphs and Telephones	2.734	2.981

Fines and Forfeitures	0.255	0.250	Native Affairs	0.350	0.340
Miscellaneous	0.245	0.305	Miscellaneous	0.129	0.175
Postal and Telegraph and Telephone	3.179	3.579	Unemployment Expenditure	0.123	0.280
			Public Debt	3.952	4.668
Total	24.252	27·433	Total Ordinary	19.720	22.137
				(1924-25).	(1926-27).
			Subsidies to Provincial Governments	4.429	5.511
Interest on Railways and Harbours Loan Capital	4.632		Interest on Capital of Railways and Harbours	4.944	5.474
Total	28.885				

* The Budgets for the two years have been compiled from 2 different sources, the former from an earlier Year-Book of the Union, the latter from the Statesman's Year-Book for 1928. Hence the slightly different grouping and combination adopted above.

Prior to 1913-14, the expenditure of the provincial Government was entirely met by grants from the Federal Government; even as the Indian Provinces before 1870 used to receive similar grants from the Government of India. Since then, various Financial Relations Acts have been passed by the Union Parliament, laying down the conditions under which subsidies are granted to the provinces, assigning to them certain revenues, and defining their powers of provincial taxation. Under Act 46 of 1925, this subsidy is based on the number of school pupils; certain revenues collected by the Union are assigned to the Provinces, and special grants made to the two smaller provinces. The aggregate provincial revenues amount to over £ 10 million; and the sources of provincial taxation comprise License fees and local dues.

Briefly, the changes in financial relations which have been effected as from 1st April 1925, are as follows :—

(1) The annual subsidy to the Provinces is based on the number of European pupils in average attendance at primary and secondary schools, the grants per head being:—Cape and Natal, £ 14; Transvaal, £ 16 7s. 6d.; Orange Free State, £ 15 8s.; though in respect of the first 30,000 pupils in each province the grant is £ 16 7s. 6d. per head.

There are other grants in respect of the various other educational activities of the provinccs, *e.g.*, training of teachers, native education, etc.

A special additional subsidy of £ 75,000 each is given to Natal and the Orange Free State.

(2) The general power of the Provinces, derived under Section 85 of the South Africa Act to impose direct taxation, which gave rise to a large number of test cases in the courts on the validity of taxing ordinances, **has been withdrawn,** and the sources from which alone they may raise revenue and legislate in regard thereto are set out in the following schedule :—

(*a*) Hospital fees and fees received for such education as is within the jurisdiction of a Provincial Council.

(*b*) Licenses required for dogs outside urban areas; licenses to take, catch, or kill game, fish or other animals, licenses to sell game ; licenses to pick or sell wild flowers.

(*c*) Licenses to own or drive any motor vehicle, or other vehicle propelled by mechanical power.

(*d*) Wheel tax or tax on vehicles, including motor and other mechanical vehicles.

(*e*) Amusements or entertainment tax.

(*f*) Auction dues.

(*g*) Licensing of totalizators, racing and the imposition on the licenses of a duty in respect of the takings thereof ;

(*h*) Taxes on persons other than companies, and on the incomes of persons other than companies subject to certain limits.

(*i*) A tax on companies other than mutual life insurance companies.

(*j*) Tax on the ownership of immovable property.

(*k*) Licenses in respect of the importation for sale within the provinces of goods from beyond the borders of the Union, subject to a maximum license duty of £310 in respect of any one importer in the Province concerned.

(*l*) Receipts of a miscellaneous nature connected with matters entrusted to a Province.

(3) The power to fix the license fees in respect of trades, professions, and occupations has been taken over by the Union. The proceeds derived from this source will, however, be transferred to the Province, together with the proceeds of Transfer Duty, Liquor Licenses, and Native Pass Fees.

(4) The power of the Natal Municipalities to impose certain trading licences has been taken away, and the grant in lieu to Natal, provided under the 1913 Act, has been abolished, as the revenue from licenses will accrue to the Province in the ordinary way under the arrangement set out in paragraph (3).

DOMINION OF CANADA.

In the Dominion of Canada, where also the powers of the constituent provinces are inconsiderable, the Budget is as follows:—

REVENUE.	1926-27.
	$
Customs	141,968,678
Excise	48,513,160
Public Works including Canals ..	1,501,635
Post Office	29,069,169
War Tax Revenue ..	156,167,434
Various	21,475,700
Total ..	398,695,776

EXPENDITURE.	1928.
	$
Public Debt including Sinking Funds	131,597,811
Charges of Management	917,050
Civil Government ..	11,827,027
Administration of Justice	2,965,200
Royal Canadian Mounted Police ..	2,049,333
Penitentiaries ..	1,762,952
Legislation	2,352,106
Agriculture	6,440,500
Health	784,800
Immigration and Colonisaion ..	3,080,000
Pensions	38,377,262
Superannuation ..	1,471,600
National Defence ..	15,914,462
Railways and Canals chargeable to income	1,030,198
Mail subsidies and steam ship subventions	804,675
Ocean and River Service	3,541,840
Lighthouse and Coast Service ..	2,878,120
Scientific Institutions	995,570
Steamboat Inspection	134,610
Fisheries	1,675,000
Subsidies to Provinces	12,516,740
Mines and Geological Survey	604,400
Indians	3,981,574
Government of North West Territories	415,000
Government of Yukon Territory ..	180,000
Public Printing and Stationery ..	183,500
Dominion Lands and Parks	4,080,022
Soldier's Land Settlement	3,375,000
Soldiers' Civil Re-Establishment ..	7,180,500
Miscellaneous ..	2,597,292
National Revenue ..	11,208,201
Railways and Canals chargeable to collection of revenue	2,403,487
Public Works—chargeable to collection of revenue	1,063,830
Public Works—chargeable to income	13,562,878
Post Office	31,849,059
Trade and Commerce	3,904,260
Labour	1,404,000
Total Consolidated Fund	330,547,025
Railways and Canals Capital	19,680,608
Public Works—Capital	2,090,000
Marine Department	1,721,780
Total Capital ..	23,492,388
Total ..	354,039,413
Adjustment of War Claims	220,000
GRAND TOTAL ..	354,259,413

Provincial (Ordinary) Revenues and Expenditures.

Province.	Revenue.	Expenditure.
	$	$
Alberta	11,912,128	11,894,328
British Columbia	20,608,672	18,230,625
Manitoba	10,582,537	10,431,652
New Brunswick	4,206,853	4,078,775
Nova Scotia	4,467,484	5,969,544
Ontario	50,841,043	51,251,781
Quebec	27,206,335	26,401,481
Prince Edward Island	832,551	736,114
Saskatchewan	13,317,398	13,212,483
Total ..	143,975,001	142,226,783

At the interprovincial conferences, which took place prior to confederation, it was decided that the new Dominion Government, was to take over permanently, as its chief source of revenue, the Customs and Excise duties that had yielded the greater part of the revenues of the separate provinces. Direct taxation was as unpopular in British North America as in any other new countries. The Dominion, also, was to assume the provincial debts, and to provide out of Dominion Revenues definite cash subsidies for the support of the Provincial Governments. On the coming into existence of the Dominion, a Consolidated Fund account was created for the Federation, and the British Government surrendered all rights to the hereditory or casual revenues of the Crown in Canada.

Provincial Governments in Canada are in the position of having, under section 118 of the British North America Act, 1867, (30 and 31 Vict., c. 3), and the British North America Act, 1907 (7 Edw. VII, c. 11), a considerable assured income paid to them in subsidies from the Dominion Treasury. In addition, through their retention of ownership of their lands, minerals and other

natural resources, the provinces, which, by the voluntaty action of their previously existing governments, entered the Confederation, raise considerable revenues through land sales, timber, mining royalties, leases of water-powers, etc. while the prairie provinces receive from the Dominion special grants in lieu of land revenues.

Further, under section 92 of the British North America Act, 1867, *Provincial Legislatures are given authority to impose direct taxation* within the province for provincial purposes, and to borrow money on the sole credit of the province. While the *liasser faire* school of political thought was predominant throughout the country, provincial receipts and expenditures were generally very moderate. From the commencement of the twentieth century, however, the Canadian Public, more especially in Ontario and the West, began to demand increased services from the Government, particularly along the lines of education, sanitation, public ownership and operation of public utilities. The performance of these functions necessitated increased revenues, which had in the main to be raised by taxation. Among the chief methods of taxation to be employed have been the taxation of corporations and succession duties, the latter showing a considerably increased yield even within the comparatively short period of five years from 1916 to 1920. Prominent among the objects of increased expenditure in this same period are education, public buildings, public works and enterprise and charities, hospitals and correction houses. Provincial Government is cheaper per head in the *laisser faire* eastern provinces; but this is not to be taken as evidence that the larger services rendered to the public in the western provinces are not worth what is being paid for them.

IV. Guiding Principles of Federal Finance deduced.

To this somewhat lengthy review of the actual conditions of federal finance in the most considerable federations of the world, we might add the example of the United Socialist Sovietique Republic of Russia in the East, and of Brazil in the West. But they all serve to bring out and confirm the following Principles.

In all federations reviewed so far, there is a clear attempt to divide the financial resources and obligations so as to correspond to the division of the powers and functions of government, as between the central federal government and the constituent states' governments. Every effort is made to make the two correspond, so as to make each unit of the federation, as well as the federation itself, as nearly as may be, self-sufficient. In practice, however, the division is seldom perfect in any federation, so as to make the resources and obligations in each instance absolutely exclusive. Links have had to be devised, therefore, which, without violating the basic principle of federal government, would nevertheless secure adequate and just resources to each of the constituent parts of a federal state. The general principle followed in making these links is to secure in each case what belongs naturally to that unit: *i.e*, concerns which are of an obviously national character, or which bear upon more than one constituent of the federation, are entrusted to the federal authority, with, of course, the incidental advantages and obligations resulting therefrom; while concerns which are of purely local character, confined to a state in each instance, are left generally to these constituent states or provinces. In practice, however, it is often found that there are very few national

concerns which have not an intimate local bearing, and *vice versa*. Modern life interacts at innumerable points, not only in the limited area of a federation, however vast in size, but also as between the several nations of the civilised world. Hence the links between the federal and state functions and resources have a double significance. It may be, indeed, that in the course of time, and with the development of new forces or tendencies not contemplated at the time the federation was first instituted, the very foundations of the federation are imperceptibly altered; and that the driving impulse of the entire federation is changed. If and where such a silent, unnoticed revolution occurs, the original distribution of authority and obligations will also have to be modified in accordance. And so we come to the following general principles, if the term be permitted, deduced from a study of the existing cases of federal finance in practice, which may well provide the basis of our study in the subsequent Lectures:—

(1) Federations are, in their nature, the creation of an urge to safeguard, among cognate peoples in close neighbourhood of one another, the political and material interests of the nation thus brought into existence. The powers and resources placed at the disposal of this new compound or federal State vary with the degree of this urge to unite—according to the nature and extent of the danger against which it is sought to provide by means of the Union, or according to the nature of the community ideals sought to be achieved. Whenever the Federal State is the result of a voluntary compact between the constituent states for the purpose, of better mutual defence,—as is but too often the case—these powers and resources are entrusted to the

Union or Federal Government at the expense of its constituents. This factor alone must be held to explain the variation in the exact shade of strength vesting in the several federations, the federation being made much stronger when the danger to be guarded against, or the interest to be promoted, was very considerable. In the eighteenth and the early nineteenth centuries, the main motive power was political—generally the dread of ambitious neighbours across the frontiers of the individually weak states, as in the case of the revolted colonies of Britain in America, or the uniting states of ancient Germany.

(2) Economic considerations of national development have, however, been exerting an ever increasing pull in the last half century and more; so that the federal organisation of a later period have been framed with a view to assure sufficient power and resources n the uniting states to effect the end in view. For this reason, almost invariably the Customs revenue has been left in all federations to the central, federal authority, as in fact, also all other indirect texation, The motive for this arrangement may have been the dread of the combining states to entrust too great and too direct an authority over their own citizens to the new State—their own creation. In all democracies, direct taxation is considered the instrument *par excellence* of making the people take a keen interest in the affairs of the State. Federations may be democratic in constitution; but if the citizens of the federation are forced to take in the federation an interest which is considered to be primarily the due of their own particular state of birth or domicile, the latter may justly feel aggrieved. Hence the earlier or more orthodox federations,—like the United States, Switzerland, or the German Confederation, not to say India,—avoided rigorously the entrusting of direct taxation

to the federal government. The course of history has compelled these old federations, in their present day form, to modify considerably the original ideal of avoiding all direct taxation in the hands of the Union government; but that does not belie the fact of the limitation once upon a time. On the other hand, Customs and Excise revenue, being indirect taxation, are not perceived to be the burdens they are by the citizens; and hence the universal vogue of leaving these, or at least the Customs revenue, to be exclusively a source of federal income.

(3) The vicissitudes of history and the consequent changes in public opinion have wrought another change in this particular instance, which is all the more surprising because nobody seems to have yet noticed it in all its intensity. The Customs Revenue was originally entrusted to the Federal authority, in order to enable the latter to have a substantial source of its own income. Since the latter half of the nineteenth century, however, the main purpose of the Customs duties in the leading federations seems not so much to raise an adequate revenue for the federal Government; but rather by its means to accomplish an intensive industrial development of the country, without which the country would be a helpless prey to its foreign competitors. Rates of the customs tariff have accordingly, been so altered and raised as, not to bring the utmost revenue to the State, but rather to render the most effective protection to the country's industry. It may be that the industrial conditions of the several constituent states of a federation might be such as to be in permanent antagonism mutually. But in that case the power to manipulate the customs revenue, so as to afford the most effective protection to particular industries, may cause the

acutest party divisions among the politicians, putting one state against another in the federation. That hitherto the financial history of the leading federations has not disclosed any such irreconcilable cleavage of interests among the constituent members of these countries, is evidence, not of there being no such difficulty in reality; but rather of the immense leeway to be covered by this means, which would trench upon no absolutely irreconcilable interests, if only the Customs tariff were scientifically devised. The instance of the Civil War in the United States of America in the sixties of the last century needs only to be mentioned to show the possibility of the lengths to which difference in economic interests may force the members of a federation to go. Moreover, the earliest framers of federal constitutions seem to have been inspired with prophetic insight. Everywhere they have forbidden the use of export duties, or hedged round this very exceptional means of national development with every possible precaution. Conditions may be imagined, as they actually are in our own country, under which scientific tariff-making of a protective character, even in regard to exports, may have the greatest possibility from the standpoint of national development. In such cases, too rigid or too numerous precautions cannot be adopted against the possibility of internecine jealousy playing havoc with either the development of the country or even its integrity.

(4) Customs revenue, however, even when it was increasingly given a protectionist complexion, did not cease to be productive at the same time. In the most rigidly protectionist countries, the customs revenue is yet a most handsome source of the federal revenue. It is supplemented in many cases by Excise Duties on home products, either for purely revenue reasons, or even for reasons of

a social nature. In either case, the federal authority is generally considered to be the most competent to achieve the end in view even if it be not left exclusively in charge of the Excise Revenue.

(5) Where, however, either Customs or Excise Revenue is, for whatever reasons, a decadent source, the problem of federal finance becomes very much complicated. Fees and fines and forfeitures—even in so far as they are left in charge of the central authority—are never an adequate substitute to the federal government for either of these sources. And if the urge of national development and more active or positive Social Reform remains strong and persistent as ever, alternatives would have to be devised, or amendments made, which may offend against the pure theory of federal financing; but which become indispensable the moment the traditional sources of federal revenue give way. Hence the incursion into direct taxation of income and property, by way of stamp duties and estate duties of all kinds on account of the federation, which seems to be a growing feature of our age.

(6) Such encroachments of the central federal governments upon what were once considered to be the exclusive preserves of the constituent state or provincial governments, have rendered necessary those schemes of Federal Subsidies to the States, which are also becoming a characteristic feature of our age. In all the British dominions, in Germany and Switzerland, the Federation partially supports the State finances by means of such subsidies, so calculated as to be sufficient to enable the States to discharge the functions laid upon them by the constitution, or other laws and conventions. History has been reversed in this case. Whether the present trend will end in so complete a centralisation as to

convert the federation into a unitary state, it would perhaps be too much to prophesy at this moment. But the fact remains, and must be recorded as the unmistakable sign of our times—that the pristine importance of the States is losing ground vis-a-vis the federation. And though the autonomy of the States is still prized and preserved in outward forms, the tendency unmistakably is to subordinate the States to the Federation of which they form part.

(7) Two unexpected—and rather intricate—consequences of this development may also be noted in this connection. While the Federal powers of levying direct taxation are growing, the States have not yet surrendered all their original rights in this regard. If the United States Government levy, since 1913, direct taxes on income,—the States likewise use the General Property Tax, and supplement it by a number of other similar taxes. Elsewhere, the subsidy paid by the Federation to its constituent states is in intent and purpose,—if not also by express convention,—in return or as a compensation for the sacrifice by the States of their right to levy direct taxes on their own citizens. Convenience in administration and consolidation in tax receipts in this age of vast, nation-wide branches of some of the most important business concerns may demand the centralisation of these taxes in federal hands. But that does not mean that the States abdicate their authority altogether. There thus comes into existence a margin of debatable ground, where both the federal and the state authorities may be simultaneously taxing the same income or property. The problem of avoiding Double Taxation has assumed, in recent years, international dimensions, and world-importance; but, quite apart from that, the conditions in almost every federation are sufficiently piquant to

lend this problem in their case an importance all its own. Agreements have been made, and laws passed, to prevent inter-statal conflict, from this cause; and it may even be ventured that the problem—whether viewed ethically, economically, or politically—is not beyond human wit to solve.

(8) Apart from questions of taxation and tax-receipts, the problem of federal finance has to consider another complication in the shape of the revenues from public property and enterprise. Public Property, in the shape of the landed domain, is, in all new countries, a common revenue-yielding asset, but usually in the hands of the constituent states. Revenue is raised from land in a variety of ways-from the ordinary taxation of land and its produce, or the taxation of the property on its passage from the dead to the living, to the sales outright of vast blocks of virgin soil. Land held and tilled in common is, however, rare in new as well as old countries, except perhaps in Russia. The State ownership of land is thus effective in theory only—used only for purposes of levying high Death Duties or Land Value Increment taxes. Forest domain, similarly, is as a rule within the jurisdiction of the constituent states. But the immense possibilities of this item for productive purposes have yet hardly been realised in even the most advanced countries, with the possible exception of Germany. On the other hand, coastal and deep sea fisheries are a reserved subject for the federal government; though the subject is used rather for taxation than as a kind of public enterprise for earning a profit or a surplus for the State. Means of transportation and communication—Railways and Tramways, canals and navigable rivers, posts, telegraphs and telephones—also form largely part of the public enterprise, mostly federal in the

larger items which have necessarily a national and an interprovincial scope. The ideas, however, which govern the revenue from such sources are so varied and conflicting that we can hardly say that they are invariably earning assets. Taken collectively, they are; but taking each unit by itself, the service expected from such units is so considerable, and is rendered so effectually, that the idea of a pecuniary profit from its operation is entirely subordinated. The gain is indirect, though by no means insignificant; and both the constituent states and the federation, in each case benefit. Exclusive jurisdiction of the Federation, in such matters as the Railways, is not the rule, even in the older countries; not only because constituent States may have vested interests already established in regard to their local railways or tramways; but because the local units may, by means of cheap and rapid transportation, develop their territory far more effectively than the federation, necessarily intent on the trunk lines of through traffic in large bulk, can. The states of the Australian Commonwealth are the most considerable examples of substantial interest in such enterprise by the constituent states deriving a heavy revenue. Shipping and ship-building, if and where a public enterprise, is a federal subject, except in the case of small local ferries.

(9) Public enterprise,—industrial, agricultural, or commercial,—has yet to be properly appreciated as a means of procuring a real surplus of wealth for the State. Writers on public finance have not yet quite realised the true nature of a tax—direct or indirect, personal or real. It is necessarily a deduction from private wealth, confiscated for public benefit. Without challenging the ethics of the arrangement, we may yet question its soundness on the score of economics. There are innumerable directions in which public enterprise can and

should be extended, where the service or commodity, whether paid for by a fee or a price, will be a direct gain to the community,--a net addition to the total wealth, whether or not it takes a tangible or monetary form. In fishing as in mining, in land as in industry, in banking as in transport, the existence of private interests makes the problem of state enterprise complicated by the question of the *modus operandi* for socialisation; and the incidental question of the ways and means for a compensation, if any.

For a federal Government, however, the advisability of resorting to profitable enterprise cannot be overemphasised. Not only in all federations, as in all modern countries, is the scope of state activity very much enlarged. and the nature of its functions very much widened, involving, in consequence, ever expanding resources; but the incessant and inevitable bickering between the state and federal authorities in regard to problems of double or overlapping taxation, and the constant wrangle about the exclusive use of this or that source of public income, make it imperative that new sources of federal and state revenue be devised. These, to be satisfactory, even though not absolutely exclusive, must be sufficiently distinct and productive. And such sources which would at the same time be found-least burdensome to the citizens at large—will be found most effectively in an extension of the Public Domain—industrial, agricultural and commercial. They would give to each component part of a federation adequate, independent, equitable, and economic sources of revenue, which would enable each such part to discharge its functions effectively. The dividing line between the State and the federal enterprise may be found in the not very difficult test as to whether or not a given enterprise is fixed and local in its character, *e. g.* agricultural land, or forests, or whether it is necessarily interprovincial

or coterminous with the federation. The former must be assigned to the constituent states, the latter to the federation. While we cannot say that this principle will be an effectual, universal solvent, or that under it there would be no overlapping margin, the administrative difficulty would be reduced to the minimum, if the principle is adopted universally of exempting from taxation any part of the public property or domain of any unit at the hands of another, federal or local.

(10) The distinctive mark of public finance is the relatively more decisive importance of the expenditure side as contrasted with the revenue. And yet we have hitherto dealt, at disproportionate length to all appearance, with the revenue side of federal finance. The explanation lies in the fact that the very insistance on revenue is with a view to indicate the increasing force of growing expenditure, both of the constituent states and of the federation. We have already alluded to the widening scope and increasing complexity of state activity in modern communities. The old function of public defence, entrusted almost universally to the federal government, is rapidly falling into the second class, in comparison with the new developmental duties laid on modern states by themselves. The monies needed for meeting with these obligations are seldom provided entirely by the current revenues. Recourse, has, therefore, to be had to borrowing ; and the interest payment on these loans, together with provision by way of sinking fund, make no inconsiderable proportion of the expenditure of modern federal states. The monies thus needed are the dictating factor in the federal search for ever expanding revenues; and hence our emphasis on the latter. The ordinary administration, it need hardly be

mentioned, is affected by this changing conception of the nature and functions of the state, and the expenditure thereon grows in proportion, both in the central Government of the federation; and in the States.

(ii.) It may also be added, in this connection, that not all the monies obtained from borrowing are spent on productive objects, which provide, ultimately at least, for their own redemption. Social Service or social reform activities on a very considerable and steadily increasing scale are generally met from tax-revenues, as the return from these services to the state or the community is in a form impossible to compute in terms of money. Both the Federation and the several states have such services assigned to them, under the constitution, or by special convention. And, though here, too, there is no exclusive division of functions as between the States and the Federation, the line of division is much clearer and more firmly marked than in the case of the revenues. The Federation either does not discharge any of these functions itself; or its role is confined to prescribing general standards, providing funds, and, perhaps, working regulations. Education in the earlier stages; local sanitation; public health; relief of destitution—these are among the most considerable of these purely local functions; while social and industrial insurance, old age pensions, unemployment benefit, general maintenance of law and order,—belong as a rule to the federal government. Further expansion—when accomplished—is distributed as between the component states and the Federation, according to the nature of the service, the requirements of its main beneficiaries, and the prevailing force of the centrifugal or centripetal tendencies as the case may be.

Allusion has been made already to the occasion for and the use of public borrowing for the dis-

charge of those functions which cannot be covered by the recurrent revenues. The power to borrow monies on the security of the general credit of the State, or, in rare cases, of any specific assets, is too precious a mark of autonomy to be relinquished easily, even when independent states voluntarily combine to form a federation. In all federations, therefore, which are the creations of a special pact, the use of the public credit belongs to the constituent states as well as to the federal government,—at least in theory. In practice, however, the fact that the states borrow in the same money market as the federation,—and often for objects much less productive than those for which the Federation has to borrow,—militates gravely against the constituents of the federation, and even at times against the federation itself. While, therefore, the power to borrow and to pledge any specific assets at the disposal of these states is allowed to rest with the states in theory, in practice arrangements have been made, in more than one federation, for the public debt of the entire federation to be managed by the central authority. Future manipulations in this debt may be made by the states; but more often at the instance of the federation, acting for itself as well as its constituent states. In India, whose experience I have so far sedulously avoided in quoting, the power to borrow in the open market has been conceded to the provinces under the Constitutional Reforms of 1920. But, with one or two exceptions, the power has not been used. Arrangements have since been made, which permit the Government of India to borrow for the entire country, the proceeds of the loans in any year being then distributed by that authority among the several claimants according to their needs. The provinces, of course, bear each their own debt, and make provision for interest and sinking fund on the same. This analogy is, in practice, adopted

it appears, in all the British Dominions federations; and though the European and American models—the United States, Germany, Switzerland—show a continuance in practice of the orthodox theory of federal finance in this behalf, it will not be too much to assert that the tendency in the immediate future, at least in practice, would be to approximate to the Indian model. Constituent states and provinces are likely, in the near future, to have less and less of those productive enterprises, and therefore of material assets, the gain from which would be measured in terms of money; and so to have less and less of the wherewithal to borrow, the more so as, besides the overwhelming might of the federation, they—the constituent states—are bound to be faced by no insignificant competition from the municipalities and other purely local governing bodies within their own jurisdiction.*

(12) Connected, by analogy as well as on account of some recent practice, with the foregoing, is the question of the federal currency, and of the monetary system in general. Coinage and Currency are, with the possible exception of Switzerland, a federal subject, including the necessary control over Banking. The connection between the control and manipulation of the currency or the monetary system in a modern state, and over the general credit within that state, need not be elaborated here. Suffice it to note that, though the control of the mint and the coinage, of the banks of issue and the paper currency in general, is assigned in modern states to the central governing

* This additional complication of the rights and duties of local governing bodies, as against the States or provinces and the Federation—I have deliberately ignored, while discussing the revenues and expenditures of the States and their federations, not because the complication does not exist, but because it would have created a factor, which, if disregarded, would not essentially affect the main argument.

authority, originally for reasons of commercial convenience arising out of the uniformity of these standards of value, the function can be and has been utilised to secure the most rigid control of the entire credit system within the country, and so to have substantial influence over the whole fabric of the national economy. When the use of this control and influence is equitable as between the several states, or the various economic interests, no objection can be taken to the arrangement, which is calculated, certainly, to yield the utmost benefit at the lowest expenditure. Cases, however, do occur,—and more can be imagined,—in which the central authority might justly be suspected of inequitable dealings through its control over the currency and the credit systems of the community. The case of India, as we shall see more fully below, provides an example, whose significance must not be lost sight of. The remedy lies not in a decentralisation of this most important as well as most historic function of the state; it is rather to be found in such legislation, regulation, or convention, for the exercise of this power, as would ensure an automatically adequate as well as equitable distribution among the several components of, and interests in, a federation.

(13.) A word in conclusion about the general supervision of the financial administration in the federal state, and the audit of its several sets of public accounts. Federations being as a rule democratic structures, with well-ordained bodies of popular representatives placed in charge of the general supervision over the financial as over any other department of administration, we need not dwell at length upon the budgetary forms and procedure. They are intended to inculcate economy and enforce responsibility upon those who are charged with the actual administration of the fin-

ances of the country. But the fact must be noted that the mere volume of the work commonly coming before the representative legislatures of modern federations prevents it exercising its powers of effective supervision over administration in details, even with the fullest use of the mechanism of special or standing committees of the Legislature set up expressly for the purpose. And this quite apart from the fact that the personnel of such committees,—not to say of the entire legislature—is seldom such as to provide the knowledge, energy, and acumen necessary for the effectual exercise of this power. In the case of the individual states, the volume of the work before the legislature is limited ; but whether because of the better talents of all the provinces being attracted by the more extensive scope of the federal legislature, or for any other reason, the fact remains that in many cases the supervision over the financial administration of the constituent states is only nominal. The power of the Legislature, however, cannot and must not be taken away. But, in the best interests of public economy, it would perhaps not be unwise to have an independent audit of the public accounts in each state, over and above the audit arrangements of the state itself. This is not to diminish in any way the inherent and indispensable right of each autonomous unit to control and supervise its own expenditure. The outside audit,—preferably by federal officers, and under a common code of audit regulations—would not only provide a valuable impartial check by a competent body ; it will secure that tallying of the outlays made with the benefit gained or service received, which generally escapes the eye of the local or departmental auditor. The purpose of the audit of public accounts needs yet to be adequately defined and understood. It consists not merely in the check of the actual figures, nor even in a rigorous tally of the legal authority

for each item of expenditure. It lies rather in a careful adjustment between outlay and benefit in the public service, which is now so rarely understood by public auditors, and so seldom accomplished. Once understood, however, and given its proper limitations, the system of outside or independent federal audit cannot but commend itself to the several constituent parts of a federa government, especially with a democratic regime.

SUMMARY OF LECTURE I.

I have now reviewed the evolution and the present practice in respect of federal finance, including what I consider to be its main characteristics and basic features. Let me, for the sake o convenience, even though at the cost of some repetition, sum up the main points in this Lecture :—

(*a*) In all federations the functions and duties of the state are divided between the central federal government, and its constituents, the several state governments. The alignment of the actual division differs, proceeding according to specific circumstances,—historical and others,—of each case.

(*b*) In consequence of the division of the powers and duties of the state, the resources and obligations in respect of finance have also to be divided. The division or distribution, to be satisfactory, must assign to each unit in the federation resources adequate to the obligations laid upon it.

(*c*) The distribution of financial resources and obligations has seldom been absolutely exclusive. There is almost always a certain overlapping area ; and the course of history has

often enforced the creation of additional area of this kind. These links, however, must be such, in their nature and working, as not to subvert entirely the very basis of federal organisation.

(*d*) In general, the obligations laid on the federal authority embrace the task of national defence, and the maintenance of national credit. Provision of productive public works or utilities, with the incidental profits or liabilities from the same, in regard to the truly national requirements, is being increasingly undertaken by the state nowadays; and in federations the central authority assumes responsibility in this behalf. The local or state governments generally look to the ordinary administration of the state, together with such items of local development and enterprise, as, in the scheme of the federal constitution, may be left to them. In proportion as the state governments have the right to utilise their public credit, they have also the responsibility of the maintenance thereof. Schemes of social reform—such as industrial insurance—are often provided for by the states with help, if need be, from the federation.

(*e*) In regard to resources, as a rule, all income from indirect taxation,—Customs and Excise,—is generally left to the central government; while, in theory at least, all income from direct taxation is or should be left to the state governments. This may not suffice for the actual and growing requirements of either, and hence the modification at innumerable points and in a variety of ways of the original conception of federal financial arrangements. Subsidies from the federal government to the constituent states governments are nowadays of increasing occurrence, though, in point of

history, the reverse process of contributions from the constituent states to the federation has been much more common. Taxation of one and the same kind by the state as well as the central authority is undesirable, though often unavoidable.

(*f*) Revenue from public enterprise, whether as a supplement or as a substitute for tax-income, has infinite possibilities, and deserves to be particularly emphasised in respect of federations. This revenue makes no deduction from the private wealth of the individual citizen, as all taxes do. On the contrary, it is the result of a net addition to the wealth of the community, taken in the aggregate; and, as such, deserves the utmost cultivation wherever there is the slightest reason to apprehend overlapping tax-revenues, and the consequent internecine jealousies.

(*g*) The use of public credit, with the incidental obligations of such use, may be distributed in federations. But reasons of administrative efficiency have often compelled federal states to make conventions among their constituents to arrange for a common use of the public credit. In all poorer communities,—particularly those in chronic need of capital for productive purposes,—the practice has marked advantages.

(*h*) The function of regulating the monetary and the currency systems of the community is centralised, on condition, however, that the administration of this function in practice is for the common benefit; involves no unfair or inequitable discrimination as between the several constituents of the federation; and that any pecuniary gain from the exercise of this function is either equitably distributed

among the constituents, or employed by the federation so as to promote the common good.

(i) The mechanism of revenue collection, if consolidated wherever possible, adds to the efficiency in collection and economy in cost, without prejudicing in any way the fundamental rights of the several constituents of a federation.

(j) To secure economy as well as efficiency in financial administration, it is of the utmost importance to have an independent audit system, scrutinising the public accounts of all the constituents of the federation, and making an exhaustive, independent report to the authority finally responsible under the constitution for the financial adminis tration of the federation and its constituents. The nature and purpose of this audit, and the mechanism of conducting it, need to be carefully defined, so as to secure the utmost economy.

LECTURE II.

Evolution of Financial Federalism in India.

" Un régime fédéral, plus ou moins étroit, sera généralement adopté dans l'avenir, parce que c'est le seul moyen d'assurer l'union des races,et plus tard de l'espice, sans briser les diversités locales, et asservir les hommes a une étouffante uniformité.

(Laveleye : Le Gouvernement dans la Dem ocratie)

" Where the conditions exist for the formation of efficient and durable federal unions, the multiplication of them is always a benefit to the world." (J. S. Mill).

" A Federation is made, not born " Marriot, p. 409.

" Our conception of the eventual future of India is a sisterhood of States, self-governing in all matters of purely local or provincial interest, in some cases corresponding to existing provinces, in others perhaps modified in area according to the character and economic interests of their people. Over this congeries of States would preside a Central Government, increasingly representative of and responsible to the people of all of them; dealing with matters, both internal and external, of common interest to the whole of India : acting as arbiter in inter-state relations, and representing the interests of all India on equal terms with the self-governing units of the British Empire. In this picture there is a place also for the Native States " (para. 349, Montford Report on *Indian Constitutional Reforms*).

" Looking ahead to the future, we can picture India to ourselves only as representing the external semblance of some form of federation. The provinces will ultimately become self-governing units, held together by the Central Government, which will deal solely with matters of common concern to all of them. But the matters common to the British provinces are also to a great extent those in which the Native States are interested,—defence, tarrifs, exchange, opium, salt, railways and posts and telegraphs. The gradual concentration of the Government of India upon such matters will, therefore, make it easier for the States, while retaining the autonomy which they cherish in internal matters, to enter into closer association with the Central Government if they wish to do so." (*Ibid.* para. 300).

The goal of India's national development may safely be taken, on these authorities, to be a federal organisation. In this each component part must be an equal of all the rest, self-reliant and self-sufficient in all its own immediate local problems, and equal partner in all that concerns the common weal. All committees and authorities, now or in future set to investigate the problem of fitting the several and seemingly incongruous parts of India's national design into a common whole, must regard this as an indisputable postulate ; and all parties concerned must accept it as the inevitable consummation of the tendencies and influences which have dominated Indian History in the last century or more. But to accept this goal is not to say that we have reached it ; and much less to hold that all the obstacles in the path of attaining it have been smoothed. It is to consider carefully the nature and bearing of these obstacles, as well as to devise appropriate, effective solutions, with due regard to all the factors that enter into and complicate the situation, that the constitutional position in India is being now simultaneously studied by two parallel committees, which will both, however, have ultimately to converge, I think, to a common goal.

The historical evolution of the constitution of India, such as it is to-day, seems to have been a haphazard development, without any specific plan or purpose ; and in which, therefore, it is as easy to discern the existence of a federal tendency, as to deny it altogether. India has been, in the course of history, a single geographic, social, and cultural unit, in spite of the admixture of races and religions from time to time, and notwithstanding the seeming conflict of these added elements. Politically, however, the attempt to classify the constitution of India, according to categories familiar to modern political science, must prove difficult, if not futile, if only because the principles

of classification now accepted seem to have had little vogue in the ages gone by of India's ancient history. Often, indeed, the geographic and cultural unity of the Indian people has been outwardly symbolised by the emanation of the centralising principle, given effect to in the classic empires of our tradition and history. The idea, and even the ideal, of an Indian Empire has never been abandoned in all these centuries; and, to that extent, the present-day sentiment of national unity and solidarity has substantial roots in a deep, deep past. But, at the height of their power and glory, these empires of India's past history must have had amidst them local units,—whether imperial satrapies, allied or conquered feudatories, or plainly and simply self-governing bodies of the village and the town,—which, were we permitted to apply to them the scientific terminology of modern politics, cannot but be said to approximate to a federal organisation. The degree of power vested in the central authority varies even in modern federations, cut and fashioned strictly to plan. Hence the exact strength of the imperial authority under an Asoka or an Akbar, even if determined, ought to be no bar to our recognising these creations of our country's political genius as federations. Even in the short period of the British rule in India, our constitutional history has had many vicissitudes, at which we shall cast a glance later on. But the fact must be mentioned here, against those doubters or critics who seem to find little warrant in India's history or tradition for the consummation of the federal goal in modern times, that, even in the short space of a century and a half, from the Regulating Act of 1773, the evolution of a federation is perfectly easily traceable; and that without any violence to the letter or the spirit of the known facts of that period. The three Presidencies of Madras,

Bombay and Bengal, existing as autonomous units before the Regulating Act, make up the basis for a federation, which the ever increasing and widening relationship,—by treaty and convention, if not by definite statute,—with the allied States in India—firmly rivet in the definite constitutional evolution that takes place after the transfer of the Government of India from the East India Company to the British Crown in 1858. I propose in this Lecture to review only the financial aspect of this evolution.

It must be noted, however, in passing at this stage, that no less an authority than Sir P. S. Sivaswamy Iyer, in his recent work on the *Indian Constitutional Problems*, has expressed some doubts as to whether a federal line of development is desirable for India. The Indian constitution, as it now stands, is federal in form, if not in intent. Sir Frederick White has pointed out, in his suggestive booklet called: "*Is India a Federation*,' that our constitution has grown by makeshifts for specific difficulties at given moments, but without any scientific plan of organisation. That, however, does not make the organisation less federal, if we can find other indicia of federalism to counterbalance the absence of a deliberate scientific planning *ab initio*. Taking Sir Siwaswamy's own definition of a Federation :—

> " The true test of a federal government is the distribution of the powers and functions of sovereignty between a central government and two or more provincial governments, in such a manner that the distribution cannot be altered except with the concurrence of both the central and provincial governments, or by the nation at large, which is supreme over both the authorities " (p. 11, op. cit.)

we find the Indian Constitution of to-day meets with every one of the requirements of a ederal organisation laid down by the learned

author. In so far as the Government of India can be said to possess sovereign powers in regard to the government of the country, there is evidently a distribution of these powers and functions as between the Central and the Provincial authorities. It is, I think, a superfluous refinement of reasoning to regard the existing distribution as no more than the inevitable decentralisation of administrative authority. The powers and functions, assigned to our existing provincial governments under the Act of 1919, are not merely a measure of administrative decentralisation. The combination of political responsibility instituted by Act of Parliament, in respect of the subjects assigned to the provincial governments, with the growing tendency toward non-intervention in the purely provincial affairs by the Government of India, must be held to be decisive, even as Sir Sivaswamy would desire it to be. And the fact admitted by that writer himself—that there can be no going back upon the principle of the existing arrangements, and that any future step in constitutional development must mean an increase of political responsibility in provincial government in a steadily widening field,—must preclude any argument which would make the present or future government of India, developing on the lines already laid down and accepted, anything but federal in form and purpose. It is not impossible, even in a federal government, to reserve a margin of power for normative or concurrent legislation in the central authority, as they have done in Germany; or to leave an undefined field of unspecified subjects for the federal authority to deal with, as is the case in Canada, or South Africa; or to make the federal law prevail in every case of conflict. These features are merely the result of historical or geographical accident, and not a matter of the constitutional essence of a federation. The

remarks, therefore, in para. 238 of the Montford Reforms, that :—

> "We suggest that it will find that some matters are of wholly provincial concern, and that others are primarily provincial, but that in respect of them some statutory restrictions upon the discretion of provincial governments may be necessary. Other matters, again, may be provincial in character so far as the administration goes, while there may be good reasons for keeping the right of legislation in respect of them in the hands of the Government of India."

do not constitute a new difficulty.

Even in so far as it has actually materialised in specific constitutional provision, or continues so to materialise, it makes no derogation from the fact of an essentially federal form of Government, definitely and finally adopted in India.

It may, indeed, be conceded that the advantages, in her present stage of political development, from a strong unitary government for India are too palpable to be questioned. There are forces at work—or tendencies in being—which would, if left to operate unchecked, split up this country into an impossible congeries of cross-sections, that cannot but affect most injuriously our national solidarity. And economic considerations in this behalf are even stronger than the political argument making for a strong central government. But to check or restrain these disruptive or fissiparous tendencies, it would suffice to vest the federal authority in India with a margin of powers, comparable, for example, to those in the Dominion of Canada, or the German Reich, and not to deny *ab initio* the principle of federation in the Indian constitution. Economic considerations have a way of asserting themselves—as for example in the financial relations between the Commonwealth and the States of Australia—which would answer for itself, no matter what the specific provisions of the constitution may be. In India, the centrifugal forces

counteracting, if not neutralising, the centripetal impulses, are of a political nature, often manifesting themselves in a racial or religious garb. I consider them to be only a passing phase, rippling on the surface only. And, besides, they cannot and do not transcend economic factors. If the federal constitution of India carefully lays out the powers and duties as between the federal and the local authorities, there need be no anxiety about the particularist tendencies in modern India frustrating the trend of national advance and solidarity.

The appendix following gives a division of functions between the central and provincial Governments, as it obtains in India to-day.

APPENDIX.

THE DIVISION OF FUNCTIONS IN INDIA.

Imperial.	Provincial (Reserved).	Provincial (Transferred).
(1) (*a*) Defence of India, and all matters connected with His Majesty's Naval, Military and Air Forces in India, or Indian Marine Service. (*b*) Naval and Military Works Cantonments. (2) External relations including naturalisation ; aliens, and pilgrimage beyond India. (3) Relations with States in India. (4) Political changes. (5) Communications to the extent described under the following heads, namely :—Railway and extra-municipal tramways not	(1) European and Anglo-Indian Education. (2) Water supplies, irrigation and canals, drainage and embankments, water storage and water-power, subject to legislation by the Indian Legislature with regard to matters of Inter-provincial relations and concerns. (2) Land Revenue Administration, (*see* assessment and collection of Land revenue,) maintenance of land records; survey for revenue purposes, records-of-rights. Law regarding land tenures relation of land-lords and tenants, collection of rents,	(1) Local Self-Government—that is to say, matters relating to the constitution and powers of municipal corporations, improvement trusts, district boards, mining boards of health, and other authorities established in the provinces for the purpose of local self-government, excluding matters arising under the cantonments Act 1910, subject to legislation by the Indian Legislature as regards (*a*) the powers of such authorities to borrow otherwise than from a provincial Government, and (*b*) the levying by such authorities of taxation

THE DIVISION OF FUNCTIONS IN INDIA.—(*cont.*)

Imperial.	Provincial Reserved.	Provincial Transferred.
classified as Provincial subjects;	Courts of Wards, incumbered and attached estates, land improvement and agricultural loans, colonisation and disposal of Crown lands and alienation of land revenue and management of government estates.	not included in Schedule I. All Governor's Provinces.
(*b*) Air Craft and all matters connected therewith.	(3) Famine relief.	(2) Medical administration, including hospitals, dispensaries and asylums and medical education. All Governor's Provinces.
Inland waterways to an extent to be declared by rules made by the Governor-General in Council or by or under legislation by the Indian Legislature.	(4) Administration of Justice, subject to Indian legislature as regards High Courts, Chief Courts, and Courts of Judicial Commissioners, and any Courts of Criminal Jurisdiction.	(3) Public health, and sanitation and statistics, subject to legislation by Indian legislature in respect to infectious and contagious diseases. All Governor's Provinces.
(6) Shipping and Navigation, including Shipping and Navigation on inland waterways, in so far as declared to be a central subject in accordance with the entry.	(5) Provincial law reports	(4) Pilgrimage within British India. All Governor's Provinces.
(7) Light-houses, beacons, lightships and buoys.	(6) Administrators-General and Official Trustees.	(5) Education other than European and Anglo-Indian

(8) Port-quarantine, and marine hospitals.

(9) Ports declared to be major ports.

(10) Posts, telegraph and telephones, including wireless installations.

(11) Customs, cotton excise duties, income-tax, salt, and other sources of all-India revenues.

(12) Currency and Coinage.

(13) Public debts.

(14) Saving banks.

(15) The Indian Audit department and excluded Audit as defined in rules framed under section 96 (1) of the Act.

(16) Civil law, including law regarding States, pro-

subject to legislation by the Indian legislature.

(7) Non-judicial stamps subject to legislation by the Indian legislature, also as regards amounts of Court fees levied in relation to suit and proceeding in the High Courts under the original Jurisdiction, and Judicial Stamps.

(8) Industrial matters, namely :—Factories, settlement of labour disputes, electricity, boilers, gas smoke nuisances, welfare of labour including provident funds, industrial insurance, and housing. Except gas and smoke nuisance, all are subject to legislation by the Indian Legislature.

(9) Stores and stationery, subject in case of imported stores and stationery to

education, provided that some subjects like the Benares Hindu University. or Chief's Colleges, shall be excluded, and some others to be subject like the control of University, the definition of jurisdiction of Universities, to legislature by the Indian Legislature. All Governor's Provinces.

(6) Public works included under the following heads : —Construction and maintenance of roads, bridges, ferries, tunnels, rope-ways and causeways, and other means of communications, subject to control by the Governor General in Council in case of military importance ; Public buildings except Governor's residences, ancient monuments except those declared to be central.

THE DIVISION OF FUNCTIONS IN INDIA.—(*cont.*)

Imperial.	Provincial Reserved.	Provincial Transferred.
perty civil rights and liabilities and civil procedure. (17) Commerce including banking and insurance. (18) Control of production, supply and distribution of any article, declared to be under the central subjects, and essential to the public interests. (19) Trading Companies and other associations. (20) Development of industries, declared to be Central subjects, and essential to public interest. (21) Control of cultivation and manufacture of	rules on the matter by the Secretary of State for India in Council. (10) Ports, except those declared to be under central subjects. (11) Inland waterways, including shipping and navigation not declared to be central subjects. (12) Police including railway police; subject in case of railway police to such conditions as regards limits of jurisdictions and railway contribution towards cost of maintenance as the Governor General-in-Council may determine	Tramways within municipa areas, Light and Feeder Railways and extra-municipal tramways, in so far as their construction and management is made by Provincial legislation, and in certain cases subject to legislation by the Indian legislature. (7) Agriculture, including research institutes, experimental and demonstration farms, introduction of improved methods, provision for Agricultural education, and such other matters relating to Agriculture, subject in certain cases to legislation by the Indian legisla-

Opium and sale of Opium for export.

(22) Stores and Stationery, both imported and indigenous, required for Imperial Departments.

(23) Control of Patroleum and explosives.

(24) Geological Survey,

(25) Control of mineral development, in so far as it is declared by law or rule to be a central subject, and regulation of mines

(26) Botanical survey.

(27) Inventions and designs.

(28) Copyright.

(29) Emigration from, immigration into, British India and inter-provincial migration.

(30) Criminal law including criminal procedure.

(13) Miscellaneous matters namely :—regulation of betting and gambling, prevention of cruelty to animals, protection of wild birds and animals , control of poison, subject to legislation by the Indian legislature, control of motor vehicles and control of dramatic performance, also subject to legislation by the Indian legislature.

(14) Control of newspapers. books and printing presses,subject to legislation by the Indian legislature.

(15) Coroners.

(16) Excluded Areas.

(17) Criminal tribes. subject to legislation by the Indian legislature.

(18) European vagrancy also subject to legislation by the Indian legislature.

ture. All Governor's Provinces.

(8) Civil Veterinary departments, including provision for veterinary training, improvement of stock and prevention of Animal diseases, subject to legislation by the Indian legislature in certain cases. All Governors' Provinces.

(9) Fisheries. All Governor's Provinces.

(10) Co-operative Societies. All Governor's Provinces.

(11) Forests, including preservation of games. subject to legislation by the Indian legislature as regards disforestation of reserved subjects.

(12) Excise, that is to say control of production, ma-

THE DIVISION OF FUNCTIONS IN INDIA.—(*cont*,)

Imperial.	Provincial Reserved.	Provincial. Transferred.
(31) Central police organisation. (32) Control of arms and ammunition. (33) Control of agencies and institutions for research and for special studies and training. (34) Ecclesiastical administration, including European cemetries. (35) Survey of India. (36) Archaeology. (37) Geological Survey.	(19) Prisons and Prisoners and reformatories, subject to legislation by the Indian legislature. (20) Pounds and prevention of cattle trespass. (21) Treasure trove. (22) Provincial government presses. (23) Election for Indian provincial legislature; subject to rules framed under sections 64 (1) and 72 (A) of the Act. (24) Regulation of medical and other professional qualifications and standards, subject to legislation by the Indian legislature.	nufacture, possession, transport, purchase and sale of alcoholic liquor and intoxicating drugs; levying of excise duties and license fees on or relating to such articles; but excluding in case of opium control of cultivation, manufacture and sale for export. All Governor's Provinces, except Assam. (13) Registration of deeds & documents of births & deaths, subject to legislation by the Indian legislature. All Governors' Provinces. (14) Religious and charitable endowments' All Governors' Provinces.

(38) Meteorology.

(39) Census and Statistics.

(40) All-India Services.

(41) Legislation in respect to any provincial subject, in so far as such subject in part II of the schedules stated to be subject to legislation by the Indian legislature, and any powers relating to such subject reserved by legislation to the Governor-General in Council.

(42) Territorial changes, other than inter-provincial, and declaration of law in connection therewith.

(43) Regulation of ceremonial titles, orders, precedence, and civil uniform.

(25) Local fund Audit.

(26) Control, as defined by rule 10, of members of all-India and provincial services, serving within the province, subject to legislation by the Indian legislature and control.

(27) Sources of Provincial revenues not included under previous heads, whether (*a*) taxes included in the schedules to the Scheduled Taxes rule, (*b*), or taxes not included in those schedules, which are imposed by or under provincial legislation which has received the previous sanction of the Governor-General.

(28) Borrowing of money on the sole credit of the province; subject to the provisions of Local Government rules.

(15) Stores and Stationery required for transferred subjects. Subject in certain cases to rules of the Secretary of State in Council.

(16) Development of industries, including industrial research and technical education. All Governors' Provinces.

(17) Adulteration of foodstuffs and other articles subject to legislation by the Indian legislature as regards import and export trade.

(18) Weights and measures, subject to legislation by the Indian legislature as regards standards. All Governors' Provinces.

(19) Libraries (other than Imperial library) museums except the Indian museum

THE DIVISION OF FUNCTIONS IN INDIA—(*cont.*)

Imperial.	Provincial Reserved.	Provincial Transferred.
(44) Immovable property acquired by, and maintained at the cost of the Governor-General in Council. (45) The Public Service Commission.	(29) Imposition by legislation of punishments by fine, penalty, or imprisonment for enforcing any provincial law, subject to legislation by the Indian legislature in case of any subject in respect of which such a limitation is imposed under these rules. (30) Any matter though falling within a central subject is declared by the Governor-General in Council to be of a local or private nature within the Province. (31) Matters pertaining to a central subject in respect of which powers have been conferred by or under any law upon a local government	the Imperial war museum, and Victoria Memorial Calcutta) and Zoological gardens. All Governors' Provinces.

Historically speaking, there has, indeed, been no *"pact"* between the central and the provincial governments in India bringing about the given distribution of powers and functions, resources and obligations. But what of that? A specific contract of this kind is not absolutely indispensable to the creation of a federation. In the examples of federal organisations now available, a pact has to be inferred; it has nowhere been expressly concluded and specifically given effect to in the federal constitution. In India, the present Government was in existence long before most—but not all—of the provincial governments were set up. The latter were, in fact, the creation of the former. Considerations of administrative convenience have, almost wholly, dictated the setting up of these provinces. The student of Indian constitution will look in vain in these provinces for that degree of initiative and authority as would bring about such a pact. Besides, not even the Government of India is absolute sovereign in the governance of the country. The legal sovereign has so far been the British Parliament, as it is also in regard to the British Dominions. The latter are, however, none the less genuine federations, even though the enactment of their constitutions was done by the British Parliament, as all subsequent amendment—in theory at least. Sir Siwaswamy's condition, in the concluding words of his definition, is thus not of the essence of a federal constitution; and hence its non-fulfilment by India need not disqualify it from being classed as a federation.

The foregoing observations, however, do not preclude our recognising that in the British provinces all the essentials and ingredients of a sound, compact, satisfactory federation are by no means so ripe as to permit the designer of a new federal constitution of India forthwith to start on his task. Not all the provinces of British India are homo-

geneous units, having among the various peoples inhabiting each of these, that common bond of racial sympathy, or economic identity of interests, that makes for the necessary measure of unity and integrity, without which the existence of any state must be precarious. That the present British Provinces may have to be redistributed and reconstituted,—more truly in accord with geographic, economic,or even racial unity,—is an aspect of the problem, which does not affect the main line of argument. This much, however, must, nevertheless, be observed in passing, that while absolute uniformity of size and importance in the several component parts of a federation is not possible, even if it were desirable, a certain conformity to a standard, a certain approach to equality among the constituents, is indispensable, if no single one of them is to dominate, overawe, and outweigh them all put together. In the pre-war German Reich, the overwhelming weight of the single State of Prussia was an eyesore to the rest of the component states, which was but very faintly remedied by the peculiar provision in the constitution as to the value of the Alsace-Lorraine vote in the Bundesrath. Profiting by the lessons of that era, the New German Republic,—which still remains a Reich and a federation,—has split up the Prussian vote, without disintegrating Prussia as a state. In India, the same end may be attained by the double and simultaneous process of reconstituting the overlarge and complex provinces, with a greater regard to ethnic harmony, economic integrity, or cultural unity of each federating unit. This principle of reconstituting provincial units in India may, if logically carried out, result in the setting up of nearly 20 provinces in place of the present nine or ten. And if large cities of over 250,000 population are made into such units, the number would be proportionately increased. On the other hand, the

infinitesimally small States or jurisdictions may be amalgamated into their own local confederations, that would then much more easily rank as the equals and partners of all the other federated units, the aggregate making nearly 50 units in the United States of India.

Into the details of this double process, it is not the province of these pages to inquire. The argument, however, may be rounded up by the mention of a factor, peculiar to India, in the shape of the Indian States. Sir Siwaswamy Iyer is fully aware of the consideration: " It may perhaps be urged" he says, "that though a unitary type may be suitable to British India, it will not be practicable to bring in the Indian States into the Indian Constitution, unless we adopt federal principles."*

The learned author, however, mentions this factor only to recognise its absolute peculiarity, and postpone further consideration. We cannot follow his example advantageously, though fuller consideration of this factor in its financial aspect must be relegated to the Lecture specially devoted to it. If Indian opinion alone had to decide it, whether in British India or in the States ; or if we had an absolutely clean slate to write upon, the majority would be overwhelming in favour of an out-and-out absorption of the Indian States with the contiguous British territories. The economic and political benefits of such a measure seem to be beyond dispute in the eyes of the present-day nationalist Indian, who necessarily postulates a self-governing India, its government responsible to the Indian people. But there is no clean slate to draw our constitution upon. We cannot argue on the assumption of such a wholesale revolution

* (op, cit, p, 14),

as would disregard existing Treaties, and undo established convention. Even on the assumption of a revolution, we may be able to dispense with the Princes; but it is more than doubtful if we can altogether ignore the historic fact of the separate existence of their States. Whatever the future constitution of India, the harmonious and beneficent working of its machinery demands that a *modus vivendi* be devised, which will permit of as large a degree of assimilation of the States with the British Provinces as is compatible with the tradition and convention in that regard. Such a happy, or at least peaceful, consummation is possible only in a federal organisation. Of course, only the larger States,—not more than a score, perhaps, all told,—can participate in the Indian Federation, each on its own account, as an equal and independent partner in the scheme. And in each such State, the form of government must approximate to a prescribed standard of minimum equality, in order to entitle it to be an equal and effective partner. The smaller States must form sub-federations of their own before they can rank and participate as equal units of the United States of India,—if the designation is allowed. The ways and means of effecting this end make a political problem, which does not concern us here. Assuming its accomplishment, however it is achieved, the federal principle will demand a redistribution, or at least a readjustment, of the financial resources and obligations, which I shall discuss in the Lecture dealing specifically with the Indian States, and their financial and economic relations with British India. The States, it may be noted in passing, are in many cases far more ancient than the British Government in point of time, even as the three older Presidencies of British India antedate the Government of India. In their case, therefore, even the

condition of a specific pact, demanded by Sir Sivaswamy Iyer is not impossible to fulfil in order to make a federation.

EVOLUTION OR DEVOLUTION?

The economic relations of the British provinces with the Government of India are themselves by no means free from difficulties, and discontent. In the shaping of the general economic policy of the country as a whole, and in the treatment of each detail there of:—finance, and currency and banking; commerce and industry; transport and communications; the utilisation or the canalisation of rivers, the ministration in all social services, and the regulation of all the compulsory contributions—the provinces have their own grievances, just as much as the central Government have their own difficulties. The same is the case,—with, if anything, much greater intensity,—with the Indian States. These feel themselves severely handicapped, thanks to their Treaty and other engagements with the supreme Government of India,—or at least to the interpretation sought to be placed on them by the senior partner in the firm. The Government of India has in such cases claimed to be the final judge as well as the advocate, and at the same time a party to the dispute. The irritation generated by such a situation cannot, to say the least, be conducive to the smooth attainment of the federal ideal held by common consent before all the members of this joint family. Hence it is of the utmost importance that, after due investigation into all the factors and antecedents, some definite, basic principles be formulated—just, as they should be generous,—which would be mutually satisfactory, and commonly agreed to.

BEGINNING OF FINANCIAL DECENTRALISATION.

Tradition, before the present British Government of India had been organised and accomplished, seems to have been for each constituent part of the empire to pay for its own government, sending the surplus of the provincial revenue to the Imperial Treasury. The feudatory states, where the local ruling princes had their own systems of government, were, of course, free from any obligation to assimilate their financial systems with those of the Empire, Except for a tribute, perhaps paid in coin or service ; and partly returned in the shape of the handsome emoluments paid to Imperial nobles and Viceroys at the court of the Mughal, the allied and tributory princes were in no wise interfered with in their internal administration by the Mughal Emperor. The silent pressure of imperceptible imitation gradually transforming local institutions, or adapting them insensibly to conform to imperial standards, must no doubt have been at work in Mughal India, as it has been in British India. There is no other explanation of the Land Revenue system, for example, gradually conforming to a common standard, even in the independent Mussulman kingdoms of the Deccan. But this must have been a result of spontaneous impulse, not of deliberate plan. In the Imperia subahs the tendency to standardisation must, evidently, have been more pronounced ; though even there local usage and established institutions seem to have been respected much more than one is at first sight inclined to believe. The genius of the Mughal administration was all for centralisation ; and so there was nothing of the type we now understand by the term Financial Decentralisation, and much less of Federal Finance. But in those days of primitive transportation and communication, the provinces of a vast Empire, like that of

Akbar and his immediate descendants, must necessarily have enjoyed a measure of financial autonomy, which could show little to conform to modern ideas, but which in practice must have approximated strangely to those ideas.

Whatever may have been the underlying principle of the financial organisation of the Mughal or the Mahratha Empire, the British started with a radically different basis. Their early settlements in this country were scattered, and unconnected, and therefore necessarily independent of one another. The only connecting link between them was provided by the common proprietorship in Engand. But the link could have been scarcely stronger, or enforced a greater degree of conformity to a common standard, than is expected of a corresponding link between the principal branches of an international banking or shipping corporation of our own days. With the beginning of more settled, more definite, more ambitious organisation, the old principle of mutual independence and local autonomy of each Presidency in India had to be maintained, if only because between the three Presidencies vast blocks of foreign territory intervened to cut them off from one another. Even after the sudden accession of power and possessions after the Karnatak wars and the Bengal revolutions, when the Regulating Act of 1773 sought to introduce an element of uniformity and centralisation, the three old Presidencies of the East India Company were all too full of their independent origin and co-equal authority to submit themselves tamely before the pinchbeck authority of the new Governor-General of Bengal. The Maratha War of the Bombay Government was the response of that authority to the centralising tendency of the Regulating Act. The difficulty of communication through and across large blocks of non-British and often hostile territories, separating one Presidency

from another, made it impossible for the Central Government to exercise its constitutional powers effectively over the provincial governments.

The principle of centralisation,—the peculiar genius of the Mughal administration,—was felt and appreciated, ever since the day Clive acquired the Diwani of Bengal, and Hastings consolidated the dominion thus gained. Subsequent Acts of Parliament concerning the Government of India all aimed at increasing the accumulation of power and authority and responsibility in the single Government of India. And when the British dominion had been sufficiently consolidated as to permit of through and direct communication between the different parts of British India, Parliament definitely enacted undoing the history of nearly two centuries, and abolished all trace of provincial autonomy, even in the Presidencies which antedate the Government of India.* True, the Governor-General-in-Council, the supreme authority for the Government of India after 1833, had himself to learn the elements of public finance as applied to a country like India. A system had yet to be evolved in the financial administration of the country, neglected inevitably before the pressing claims of war, and conquest, or king-making. The constitutional supremacy of the Central Government remained so, therefore, in theory only. In theory, all the revenues from all the districts under the administration of the Company were collected by their local officers on behalf of the Government of India; and all expenditure defrayed in the name of the same authority only. In practice, the local

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* *Cp.* Ss. 39 and 59 of the Charter Act of 1833, 3 and 4 Will-IV, c. 85.

"No Governor shall have the power of creating any new office, or granting any new salary, gratuity or allowance, without the previous sanction of the Governor-General."

"The supreme government controlled the smallest details of every branch of the expenditure. Its authority was required for the employment of every person paid with public money, however small his salary; and its sanction was necessary for the grant of funds. even for purely local works of improvement, for every local road, for every building however insignificant."*

"The distribution of the public income," wrote General Strachey, "degenerates into something like a scramble, in which the most violent have the advantage with very little attention to reason. As local economy leads to no local advantage, the stimulus to avoid waste is reduced to a minimum; so, as no local growth of income leads to an increase of the local means of improvement, the interest in developing the public revenues is also brought down to the lowest level."

governments must have had a pretty free hand, not, indeed, as in the glorious days before the Charter Acts, but sufficient to enable them to minister to the needs of their province from the revenues collected therein under the authority of the Government of India. Even this freedom, however, was limited, and indirect. It must, further, have varied considerably as between the three older Presidencies, and the new provinces created by the Government of India of their own authority. The new creations could not possibly challenge the authority of their parent body; and their easy submission brought about a corresponding change in the attitude of the older Presidencies.

With the transfer of the Government of India to the British Crown in 1858, the tendency to centralisation began to stiffen. The spread of railways, and telegraph helped to make the power of the Central Government more rigid and more direct. After a century of financial mismanagement, the Imperial Government were, in the years immediately following the transfer, almost morbidly anxious for economy and retrenchment.

* "*The Finances and Public Works of India,*" by the Strachey brothers, p. 131.

Inevitably, the provincial governments felt the full pressure of this retrenchment. They naturally resented a regime which precluded them from accomplishing their own pet projects of provincial development.

The Central Government, on their side, not only had to economise to meet the heavy cost of buying and making an Empire. They had a suspicion, by no means unfounded, that the provincial satraps were clamouring for money only to add to their own importance:

THE MAYO SCHEME OF PROVINCIAL FINANCE.

The Government of India could not but perceive the force of such reasoning. And yet, their own necessity for a certain system and regularity in their Budget, compelled them to devise means of inducing a degree of responsibility in the provincial authorities, and a measure of economy in their expenditure, which was, since 1833, progressively lacking. Financial devolution, when it at last came in India, was rather a measure of administrative convenience, than an index of a political reconstruction. The imperial authorities were made to realise, by the force of circumstances, their own inability at once to control and carry out works of material benefit to the country ; and also to keep provincial authorities well within the margin. The only solution was to entrust the provincial authority with certain specified amounts for expenditure in provincial administration, under the system established and regulations enacted by the Central Government. Lord Mayo, in a Government of India Resolution of 14thDecember, 1870, first outlined the principles of a scheme of financial decentralisation as he conceived it. A number of minor departments of administration—

like Jails, Registration, Police, Education, Medical —were made over to the provincial governments; and a lump sum grant of Rs. 4,68,87,110 was assigned to the provinces for expenditure on the same. This amount was distributed as between the several provinces by the Government of India, on the basis of the requirements of each province, as shown by the accounts of the Government of India. Receipts from these departments were at the same time made over to the Provinces. And if, along with the grant, these funds did not suffice for the needs of any province in the departments entrusted to it, the latter must depend on its own resources. The grant was not to be increased, nor,—except in extraordinary circumstances,—to be diminished. Within the lump sum assigned to it, each provincial government was given a free hand for reappropriation; and if it succeeded in making economies by its own improved budget system and supervision, the unspent balance was to accumulate to its credit with the Government of India.

Not a radical change in the principle of government, this nevertheless made a considerable and welcome step forward. Once taken, there was no going back on the principle of Decentralisation; and it was only a question of time when it would be metamorphosed into a principle of federalism. The Government of India expressly reserved, in 1870, their powers of supervision and control, even in the departments thus provincialised. But within the margin created by their Resolution, there was basis enough for the provinces to make ever increased demands for further concessions. And the provinces could make an excellent —almost unanswerable case for the reconsideration of this arrangement. It was only an annual arrangement, lacking that element of stability, which was essential for the improvement of provincial finance. The

assignment, moreover, made to each province was on the basis of the actual expenditure in each province under a given head. But the underlying assumption that the actual expenditure represented the real needs was unfounded, and the provincial governments had justly complained against the imperial exigencies stifling their local scheme of improvement. Again, as between provinces, there were gross inequalities of burdens and grants ; and Lord Mayo's scheme only served to perpetuate these inequalities. A really equitable basis of assignment was, indeed, very difficult to discover, but that was no justification for perpetuating an inequitable system. The provincial governments, moreover, had little direct interest of their own to be diligent in revenue collections. Stamps, excise, or customs showed considerable leakage, which was impossible to stop while the authorities on the spot lacked the incentive to be vigilant. The only thing that could be said in favour of the Mayo scheme was, that, defective and experimental as it was, it had secured its main object of bringing about a greater harmony between the central and the provincial governments, and of making the latter more economical in expenditure than they had till then been.

REFORM AND READJUSTMENT BETWEEN 1877—1900.

The defects of the scheme, such as they were proved to be by experience, were not irremediable. The next step forward under Lord Lytton in 1877 made over the remaining civil departments, along with their receipts, to the provinces, except those directly administered by the imperial government. The new services thus transferred included Land Revenue, Excise, Stamps, Law and Justice, General Administration, Stationery and Printing. For administering these, instead of a lump sum grant, a share was given to the provinces in specified

sources of revenue, which had suffered because of the lack of provincial vigilance. Excise, Stamps, Law and Justice fees, proceeds of the License Tax and some minor railways receipts were thus made over. The principle of partnership—unequal, indirect and indefinite as it was—was thus introduced for the first time; and thereafter there could be no questioning of the line of march. The revenue from these sources was to be taken in part by the provincial governments; but if they showed any surplus over an estimated figure in each of the provinces, the imperial government were given one half of the surplus. In case of a deficit, the same authority agreed to bear half the loss. The rates and items of taxation in these as in other departments were settled by the Imperial Government alone; but the admission to a share in the yield of the revenues was a distinct step forward on the road to federalism. The Governor-General-in-Council relinquished not an iota of his powers of supervision and control, but simply expected the execution of these powers to be facilitated under the arrangement.

> "What we have to do" said the Finance Member, in his Financial Statement for 1877-8, "is not to give to the local governments fresh powers of taxation, but, on the contrary, do all that we can to render fresh taxation unnecessary, and to give to these governments direct inducements to improve those sources of existing revenues which depend for their productiveness on good administration."

The arrangement, under the new scheme, was necessarily different with each province; and so the principle of a seperate agreement in each case came into existence. To avoid the possibility of perpetuating an inequitable arrangement, the contracts were made revisable every five years. The total provincial revenues under the new scheme amounted to Rs. 10 crores, besides a lump sum grant of 4¼ crores, and the exclusively provincial

income of 3 crores—a very substantial increase. Looking at these arrangements after all these years, and in the light of subsequent history and present-day ideas, it is interesting to note how the authors of the scheme looked upon it, and how the several provinces received it. Madras, under the refractory governorship of the Duke of Buckingham, refused to come within the arrangement ; while in Burma and Assam, the arrangement made over to the provincial governments concerned all the revenues and expenditure that could possibly be treated as provincial, and the balance was made up by a fixed share of land revenue, forests and other items. Sir J. Strachey, the then Finance Member of the Government of India and author of these contracts, seems to have had very confused notions of what should be truly imperial, and what provincial, sources of revenue in a proper federation. Says he :—

> "The revenues and charges arising from tributes, salt, opium, allowances and assignments, administration of the post-office and telegraphs, the political department, the East Indian Railway, the guaranteed Railway Companies, and all items recorded only in the accounts of the Central Government, would have remained wholly imperial. The revenues from forests, excise, and assessed taxes, stamps and registration, and the import duties on liquors, would have been shared equally between the local and central governments. Each local government would have received a fixed proportion of the net land revenue to make good the difference between its assigned revenues and expenditure."

The fact that he allows direct and indirect taxes—like the assessed taxes and liquor import duties of his days—to be shared indicates his lack of a proper appreciation of the problem of federal finance. But then it may well be urged he had no idea of devising the financial system of a federal organisation, but simply arranging for a greater administrative convenience and economy in a fundamentally unitary government.

The next stage in the history of federal or decentralised finance in India seems to be somewhat retrograde, at least at first sight. The contracts of 1877-8 were necessarily different with the different provinces, since it was felt uniformity might be purchased at too great a cost. The share of the central government in certain branches of revenue seemed to be less liberal than it might have been ; while the interest for effective administration by the provincial governments in certain others was less than it should be. Major Baring, later Lord Cromer, the Finance Member of Lord Ripon's government, made the new contracts in 1882, which made over to the provinces all the income from specified departments, and abolished Lord Mayo's corner-stone of a lump sum grant. Forests and Registration, instead of being wholly provincial, were divided for the most part equally between the Provinces and the Government of India. The balance for the provinces was made up by a fixed share of the Land Revenue. The total provincial resources under the quinquennial contract of 1882-3 were made up of the marginally

Revenue from	*Amount.*
	£
Wholly Provincial heads	4,000,000
Divided heads	8,009,000
Varying proportion of certain other heads ..	23,000,000
Nominal from others	7,000,000
Total of all Provinces ..	42,000,000

noted items. Taking the rupee at £ 1–8*d.*, this represents over 50 crores of revenues in which the provinces were given an interest. The only contingencies, which could at all unsettle this were : War and Famine. As regards the former, it was settled that no demand was to be made on the provinces, except in the case of a disaster so abnormal as to exhaust all the reserves of the

supreme government, and to necessitate the suspension of the entire machinery of improvement. This was to safeguard the provinces against such inroads on their resources as had occurred during the Afghan War. As for Famine, the central government undertook to come to the rescue of the provincial governments in the event of a famine so severe as to embarrass the provincial government fighting it on its own resources. The Imperial government would provide every year a million sterling by way of insurance against famine, so that the provincial governments need make no provision in that behalf normally.

In the remaining years of the last century, the dominating circumstances in Indian finance was the falling exchange value of the rupee. The provinces, however, were not much affected by it. But the possibility of undue haste in spending, especially towards the end of the contract period, was guarded against, since 1884, by the requirement of maintaining with the Government of India a prescribed minimum balance by each province, which was under no circumstances to be drawn upon. The revision of the contracts in 1887 brought a net relief to the Imperial treasury of Rs. 55 lakhs a year from the increased provincial receipts—a welcome help against the falling rupee and the rising military expenditure ; while in 1892 the same operation gave a further relief of over 46 lakhs. The accumulated balances of the provincial governments were three times confiscated, the " loan " being refunded only twice, 1891 and 1895. A Committee of 1887 on this subject recommended the permanent abolition of this expedient of a forced " loan " from the provincial balances, and securing to the provincial governments absolutely half the normal growth of their revenues to enable them to keep up a continuous policy of internal improvements. The Govern-

ment of India could not accept the suggestions, for reasons already mentioned. In the last quinquennial settlement of the century (1897), an estimate was made of the expenditure on provincialised services in each province, and an adequate proportion of the provincialised revenues was set aside for the purpose. The provincial governments, speaking generally, retained all the income from provincial rates, courts of law, jails, police, education, medical, local marine services, pensions contributions, major and minor irrigation works, certain state railways, buildings and roads, and stationery; one-half of the Stamps revenue, assessed taxes, Forests and Registration receipts; and one-fourth of the Excise and Land Revenue. Expenditure on most of these heads had to be met by the provinces, and a share of the cost of collection corresponding to the proportion they received. The cost of land revenue collection was, however, wholly provincialised, except in Bengal. Within the limits of their resources, the provinces were made responsible for famine relief, and some political and miscellaneous expenditure. The total revenues exclusively provincialised was, in 1901-02, Rs. 25.12 crores, while the total collections in which they were at all interested were 46.33 crores, or nearly half the gross revenues of India.

These developments and alterations were justly considered to be retrograde. The overwhelming excuse of Exchange and Famine made the Government of India's arguments unanswerable in the closing decade of the century. But, with the stabilisation of Exchange (1899), and systematisation of the policy in regard to Famine, (1901-2), the case for the provinces began to gather strength. The governing principle in the thirty years of provincial finance, since its inaugeration by Lord Mayo, had remained unaffected : *adminis-*

trative convenience—for the Government of India almost invariably. There was no thought of a radical change in the constitution of India on federal lines. The Government of India were absolute masters of the situation ; they varied and re-formed the contracts at their discretion, or for their convenience. They insisted on the maintenance of minimum balances, ostensibly to guard against provincial extravagance. But, when the need arose, they confiscated these balances without so much as " by your leave " to the provinces ; and held it up as a great concession when they refunded the "loan." The needs of the provinces for material development, social reform, educational progress, were never suffered to eclipse for a moment the requirements of the Government of India to balance their exchange losses or make good their military extravagance. The very economy, which was claimed to be a merit of the system, was purchased at the cost of efficiency in local government ; and, as such, it could scarcely be praiseworthy under an enlightened, progressive, popular government. The imperial burdens on the several provinces were without a plan or purpose, lacking in any intelligible principle, as the late Mr. Gokhale showed to the Welby Commission. No test but economy in the provincial spendings was recognised, because no basis save the convenience of the Imperial Government was admitted. The provincial governments, therefore, necessarily got the worst in every reshuffling of the cards, because from the very outset they were debarred from having trumps. While the provincial expenditure had to be rigorously kept down, the Imperial went on steadily increasing on every available pretence of War, Famine, Exchange, or Opium failure. Neither borrowing on their own credit, nor additional or supplementary taxation on their own hook, was allowed to the provinces, who therefore

remained irretrievably tied to the apronstrings of the central government.

Quasi—Permanent Settlements.

In the early years of the present century, most of the excuses of unstable finance in the Government of India had been remedied. The case for the provinces was well founded in the need for a continuity of policy in projects of moral and material development, which the government of India had no means of answering. Subject, therefore, to their theoretical right to revise the contracts every five years, and resume the provincial balances with them if their own abnormal needs dictated to them such a course, the Government of India agreed, in 1904, to the following principles for a semi-permanent arrangement :—

(1) The provinces must be given a more permanent interest in their revenue and expenditure.

(2) The share of the revenue assigned to each province separately, and to all provinces collectively, should bear approximately the same ratio to the provincial expenditure, as the imperial share of growing revenues bears to the Imperial expenditure.

(3) The provincial assignment must include a slightly larger share of growing revenues.

On these lines were the new contracts made when they fell due to be revised. The distribution of revenue resources under the three classes of wholly Imperial, wholly provincial, and divided, was left substantially unaltered ; but the share of the provinces was altered in conformity with the above principles. The basis taken was the relative

proportion of the Imperial (3/4) and the provincial (1/4) expenditure, in the total expenditure of the country, with due regard to (*a*) the needs of backward provinces, (*b*) the special projects of reform suggested by the Imperial Government, and, (*c*) the yield of the exclusive heads of revenue—Imper ia or Provincial. Special initial grants were made to certain provinces (150 lakhs), while additional grants for specific purposes aggregated 162.5 lakhs. A more liberal arrangement was made in respect of Famine Relief, by the Central Government setting aside every year a sum roughly equal to the famine liabilities of each province to the credit of that province, and utilising this accumulated reserve when a famine occurred, without affecting its normal resources. If this did not suffice to meet the particular liability, the excess must be met equally by the Imperial and the provincial government concerned. As the total expenditure on the departments made over to the provincial government for administration exceeded considerably the revenue assigned to them, the difference was made up by a *fixed cash assignment* under the Land Revenue.

These changes, were considered to be tantamount to a change in the governing principle by the Royal Commission on Decentralisation (209) :—

> "The distribution of revenues between the central and provincial governments was made, except on occasions of grave emergency, with direct reference not to the needs of the Central Government, but to the outlay which each province might reasonably claim to incur upon services which it administered. The first step considered in concluding a settlement was to ascertain the needs of the province and assign revenues to meet them, the residue only of the income of the province coming into the Imperial Exchequer." *

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* Quoted in the *Sixty Years of Indian Finance*, p. 454, from which has been summarised the story of the decentralisation as given in the foregoing pages.

These remarks if they apply at all, can only apply to settlements concluded after 1904. The Central Government still held all the purse-strings of the country, as evidenced not only by the fixed assignment made by them, but also by their clearly reserved right to revise the settlements with the provinces. They had agreed, indeed that this power would be "exercised only when the variations from the initial standards of revenue and expenditure were, over a substantial term of years, so great, as to result in unfairness either to the province itself, or to the Government of India ; or in the event of the Government of India being confronted with the alternatives of either imposing general taxation, or seeking assistance from the provinces." But, inasmuch as the provinces had no right to judge of the reasonableness of the emergency pleaded by the Government of India, the condition inserted in the concluding portion of the remark is more than a thin end of the wedge driven in the budding system of the financial autonomy of the provinces. The provinces, moreover, had other causes of complaint against the Central Government making their specific grants in furtherance of given projects an excuse for an undue degree of interference. The provincial revenues were absolutely beyond the power of the provincial government to manipulate, the rate being fixed in all cases exclusively by the Government of India. On the expenditure side, too, they were powerless to alter the established trend, or to create charges on the provincial purse exceeding a prescribed figure, unless sanctioned previously by the supreme government. "Altogether" I have observed in another work * "the decentralisation of finance, as it obtained between 1904 and 1912, afforded a spectacle of a conflict between the old principle of observing the convenience of the imperial government and the new ideal of encouraging the development of the provincialised services."

* Sixty years of Indian Finance. p. 455-6.

Indian public opinion, such as it had come to be by this time, came to support heartily the provincial case; and the late Mr. Gokhale in his evidence before the Welby, as well as the Decentralisation, Commission distinctly argued for a reorganisation of the Indian financial system on a clearly federal basis.

The main points, then, on which issues were joined were :—(1) the system of "divided heads" claimed to be injurious to provincial development; (2) the practice of the fixed assignment, which made the arrangements unduly rigid; (3) the spasmodic grant of lump sums for definite purposes, inadmissive of any discretion to the provincial governments, and productive of a needless degree of interference; (4) inequalities, *inter se*, of the several provincial settlements, which led to jealousies and recriminations; and (5) the absence of any powers of additional or extra taxation for the provincial government, or of borrowing, which precluded them from substantially improving their ordinary administration, or taking up more ambitious schemes of economic development. The Government of India themselves perceived the force of some of this reasoning; and in the fresh settlements of 1911-12 they sought to convert the fixed assignment into completely provincialised revenues from heads which were till then divided. Excise and Forests revenues had been recommended by the Decentralisation Commission as fit items for wholesale provincialisation. Accordingly, in the settlement of 1911, the forests revenue and expenditure were wholly provincialised in all provinces; excise, too, entirely in Bombay, and to the extent of 3/4 in the Central and the United Provinces, the cash assignment being reduced in proportion to the accretion in revenues from these changes. Land Revenue was half provincialised in the Punjab, which also got half a share in t h

major irrigation works; while Burma secured 5/8 of the Land Revenue. The rule was thenceforward generalised that:—

> "Fixed assignments should be replaced by a share of growing revenue in the following circumstances only:—
>
> (*a*) When an assignment is so large as to prevent the increment in revenue from keeping abreast of the legitimate and necessary growth of expenditure; and
>
> (*b*) when the financial outlook of the moment justifies the abandonment of the necessary amount of growing revenues in exchange for the reduction of fixed charges." *

With regard to the other grounds of complaint, the supreme government agreed, on the recommendation of the Decentralisation Commission, that:—

> (*a*) the special grants for definite objects must not lead to a greater interference with the provincial governments than had been the case till then:
>
> (*b*) that the wishes of the provincial government as to the object most needing this extra aid in their province should have due regard shown to it: and
>
> (*c*) that, finally, not necessarily the same object should be selected in the several provinces for the benefit of the grant.

As for the inequalities in treatment as between the several provinces, the Government of India held there was no definite standard to guide them in arriving at an equal treatment. Besides, they could not "believe that inequality in settlement had gone far enough to starve one province in its necessities in order to load another with luxuries". Finally, in regard to the provincial claim for independent powers of borrowing and taxation, while recognising all the force of the provincial argu-

ments, the Central Government nevertheless could not agree to a further step in devolution in these respects.* "No taxation without representation" is an old adage in self-governing countries, which the Government of India re-edited for their own purpose to say: "No taxation without responsibility." The Provincial Governments, upto 1920, owed no responsibility to the people they governed. The Government of India were themselves an absolute and irresponsible bureaucracy; but they owed a shadow of responsibility to the Secretary of State for India, who, in his turn, was supposed to be responsible to Parliament. They, accordingly refused to concede any powers of independent taxation, direct or indirect, to the provinces, on political as well as financial grounds. And, lest provincial competition with the Government of India, committed to heavy projects of material development, requiring considerable annual borrowing,—should prejudice the credit of the Central Government, they likewise declined to allow provinces to borrow on their own credit in the open market.

BEGINNINGS OF FEDERATION.

This was the position, in brief, when the War came. During the continuance of that struggle, every question of radical character had necessarily to be suspended. The problem of further decentralisation—or financial reconstruction, if you prefer the expression—thus came to be considered alongside the larger question of constitutional reforms, or rather as a consequence of the latter. The guiding principles, the basis, for the new financial arrangements was provided by the con-

* Resolution on Provincial finance of May, 18, 1912, p. 7

stitutional changes already adopted in principle. As the principle of responsibility in provincial government had been accepted, the aspect of the financial question changed altogether in 1919-20. The Government of India had themselves declared, in their comprehensive Resolution on the subject:--(May 18, 1912. para. 12).

> "Financial autonomy for the provinces, if and when it arises, must carry with it the power of taxation"

But the new financial arrangements, when they came to be made at last, inevitably came as a continuation,—an organic growth, of the system as it had been developing for a half century past. According to the Budget for 1919-20, the share of the Imperial and Provincial governments in the national revenues was as shown in the table overleaf, the provincial revenues being 30% of the total, or about 43% of the Imperial Revenues.

Table showing the amounts of Imperial and Provincial Revenues according to the accounts of 1919-20.

(*N.B.*—Figures are in thousands of rupees.)

Heads of Revenues.	Imperial.	Provincial.	Total.
	Rs.	Rs.	Rs.
Land Revenue	16,69,08	17,42,41	33,91,49
Opium	4,55,62	..	4,55,62
Salt	5,74,79	..	5,74,79
Stamps	5,56,24	5,34,93	10,91,17
Excise	5,51,71	13,74,22	19,25,94
Provincial Rates	2	5,32	5,34
Customs	22,48,32	..	22,48,32
Income Tax	17,93,86	5,26,92	23,20,78
Forests	22,97	5,13,78	5,36,75
Registration	1,49	1,07,05	1,08,55
Tributes	93,28	..	93,28
Total Principal heads ..	79,47,42	48,04,65	1,27,52,08
Interest	4,52,06	53,80	5,05,86
Posts and Telegraph ..	9,20,39	..	9,20,39
Mint	2,67,99	..	2,67,99
Receipts by Civil Departments	38,78	3,00,70	3,39,49
MISCELLANEOUS—			
Superannuation	16,57	15,59	32'17
Stationery and Printing ..	8,42	11,47	19,90
Exchange	..	..	..
Miscellaneous	1,75,58	43,09	2,18,67
Railways account	31,83,56	.5	31,83,58
Irrigation account	4,02,10	4,72,82	8,74,93
Other Public Works ..	10,03	45,46	55,49
Military Receipts	3,90,52	..	3,90,52
Total Ordinary Revenues ..	1,35,26,48	60,34,61	1,95,61,10

* These figures are taken from the Budget of the Government of India for 1921-22. The very last year of the old arrangement was 1920-21 ; but only these actuals are quite satisfactorily illustrative.

Table showing the amounts of Imperial Expenditure according to the accounts of 1919-20.

Heads of Expenditure.	Imperial.	Provincial.	Total.
DIRECT DEMANDS ON REVENUES—	Rs.	Rs.	Rs.
Refunds, etc.	1,66,02	57,94	2,23,96
Assignments, etc. ..	90,03	1,07,15	1,97,18
Collection Charges.. ..	6,33,76	11,95,10	18,28,87
Interest	11,03,98	47,65	11,51,64
Post Office	6,84,71	..	6,84,71
Mint	48,54	..	48,54
Salaries and Expenses of Civil Departments ..	7,75,04	30,58,95	38,34,00
MISCELLANEOUS—			
Civil Charges	4,44,89	3,88,23	8,33,12
Famine Relief	1,41,47	29,28	1,75,76
Railways account	17,92,98	11	17,93,09
Irrigation account	2,89,91	3,44,96	6,34,87
Other Public Works ..	1,61,56	9,02,15	10,63,71
Military Services	87,25,32	..	87,25,32
Adjustment on Exchange account	10,89,57	..	10,89,57
Portion of Provincial allotment not spent by them ..	..	1,10,68	1,10,68
Provincial expenditure spent from balance	..	—42,53	—42,53
Total Expenditure charged to Revenue	1,58,91,77	60,34,61	2,19,26,39

You will note that while the aggregate provincial revenues are a little over 30% of the total, the aggregate provincial expenditure is much under 27½%, and of this a considerable portion shows economy over the allotment actually made to them. The provinces bear 65% oi the collection charges for revenue, nearly 80% of the civil administration charges, 90% of the Public Works cost, and 55% of Irrigation expenduture. On the Revenue, side they get a little over half the land and stamps revenue, two thirds Excise. less than a quarter of the Income Taxes, and the bulk of the Forests and Registration revenues, as also 90% of the departmental fees and receipts. All the items unspecified in this summary go to the Central Government.

The Imperial Government bore all the charges for the army, the debt, communications, and a small proportion of the charges for general civil administration of the country. There were, on both these sides, obvious defects, which made the arrangements generally unsatisfactory. The Montford Report on Constitutional Reforms enjoined a new principle to govern the arrangements :

> "If provincial autonomy is to mean anything real, clearly the provinces must not be dependent on the Indian Government for the means of the provincial development. Existing settlements do, indeed, provide for the ordinary growth of expenditure ; but for any large and costly innovations, provincial governments depend on doles out of the Indian surplus. Our idea is that an estimate be first made of the scale of expenditure required for the upkeeping of the services which clearly appertain to the Indian sphere ; that resources with which to meet this expenditure should be secured to the Indian Government : and that all other revenues should then be handed over to the provincial governments." *

Though the distinguished authors of the 1919-20 Reforms consider their proposals to form a radically different stand-point, there is nothing, either in their statement of principles or in their specific suggestions for changes in the concrete, to indicate an orientation in principle equal to a complete federalism. The basic condition for a federal financial organisation is not merely adequate funds for this or that part of the federated governments. There must be a distinct, established sense of political responsibility of the governing authorities to the people's representatives, as well as of financial initiative, without which no concession in powers of taxation could be advantageously made. The proposals for constitutional reforms put forward by the committee of Mr. Montagu

* *Cp.* para. 201, of the *Report on Indian Constitutional Reforms*.

and Lord Chelmsford made a beginning in the direction of governmental responsibility to popular legislatures. But they stopped far short of that fullness of responsibility in the constituent units, without which federal institutions cannot function satisfactorily. In financial initiative, they could not tear themselves away from their past. Their expressions sound very liberal; but the actual accomplishment was meagre, if federalism was their goal. Thus, the needs of the Central Government are as supreme and decisive under the Reforms of 1919-20, as they ever were before. These needs are by no means very modest. They absorbed, before the Reforms, nearly 3/4 of the aggregate revenues of the country. The authors of the changes of 1919-20 make no secret of their conviction that these needs must be first served. What would it avail the provinces, if, thereafter, all that remained of the revenue resources was made over to them? Very little, as a matter of fact, remained to swell the provincial purse; and out of that a stated contribution had to be made by each province to meet the estimated deficit in the Indian central finances. As that contribution was to rank as a first charge on the provincialised revenues, the arrangement made in 1920 gave to the provinces with one hand, and took back,—at least for a while,—a goodly portion of it with the other. Where, then, lay the "advance" claimed to be made by the new dispensation?

In the arrangements proposed by the Reforms Report, the so-called "divided heads" of Revenue and expenditure were abolished. Land Revenue, Stamps, Excise were wholly provincialised, Customs, salt, opium and Income Tax remaining wholly imperial. Of the productive departments of public enterprise in India, the Post office, Mint and Currency, Telegraphs and Railways, were made wholly Imperial, while Irrigation Works

entirely provincialised. On the expenditure side, the central government charged themselves, generally speaking, with the cost of defence, interest on that portion of the public debt which could not be charged to the provincial accounts, the expenses of their commercial services, like the Railways or the Post Office, and such other items of the ordinary civil administrative expenditure as remained directly under the central government. The provinces were made to bear all their existing departmental expenditure, together with the cost of collecting provincialised revenues, the cost of irrigation, famine charges according to a prescribed scale, and interest on the debt charged to their account.

This arrangement, when translated into figures, on the basis of the latest available accounts, showed a considerable deficit in the central Budget, even on the then prevailing scale of expenditure. The authors of the Reform proposals sought to make the deficit good by lump sum contributions from the provinces, until the Imperial revenues expanded—or new taxation was imposed—to make up the deficit. As no other arrangement would leave each province with a surplus of its own, the Indian Government had perforce to agree to the suggestion, and not because they thought it to be essentially sound. We shall revert to these contributions, and their *modus operandi* later. Here let us note that the arrangement contemplated certain limited powers of extra taxation by the provinces on prescribed heads, should a local government desire to improve its scale of administration. In the main branches of revenue assigned to them, they had powers to vary the rates of taxation, except in regard to the Land Revenue, which in some areas is permanently fixed, and in others fixed for a long time. As the Land Revenue in most provinces is the mainstay of the provincial

finance, the arrangement obviously tied the provinces up far too much to entitle them to consider themselves as equal partners in a federation.

The Government of India were quite positive on the question of the provinces' right to borrow. " The demand for entire liberty to borrow we cannot possibly accept; " they declared sententiously in their *First Reforms Despatch*, para. 62. The Indian money-market had limited possibilities; and the Government of India rightly apprehended that the demands upon it in the years that followed would be heavy enough to need careful nursing. They would, therefore, avoid all embarrassing, or needless, competition from or among the provinces, and suggested laying down general rules to facilitate as well as regulate provincial borrowing. Eventually, though the right to borrow has been conceded in theory, it can be exercised under so many restrictions that the provinces find it the most economical to borrow through the Government of India.

When the division of resources and obligations, revenues and expenses, had thus been made between the central and provincial governments in British India, it was found that the Budget of the Government of India would show a deficit on the then existing scale of expenditure. That a part of the increased expenditure was due to the fall in the purchasing power of money seems to have escaped the attention of those who had the remodelling of the federalised finance of India in their hands. They also overlooked,—or ignored,—the possibility of new or increased taxation by the Government of India to make the latter's both ends meet. Hence they believed themselves to be forced to devise some kind of contributions from the Provinces for the purpose, subject to reduction

and remission of the same when the rehabilitated finances of the Government of India permitted them to do so . The Committee appointed to advise on the problem was presided over by Lord Meston, a retired Indian Civilian, with some experience of Indian finance ; and that body estimated the deficit in the Central Budget, after making all the adjustments on either side, to be Rs. 9·8,366 crores. As under the new dispensation the resources of the Provinces had been increased,—in comparison, that is to say, to the resources at their disposal before the Reforms of 1919-20 ; and not in comparison to the real needs of the provinces,—the Montford Report had itself prescribed the basis of the "realised surplus" for calculating the contribution payable by each province. The contribution appeared to the provinces inevitably in the light of a burden, which, moreover, turned their seeming surplus into a deficit, even without improving those branches of administration and activities of nation-building, which were placed in their charge by the Constitutional Reforms in the hope that, under autonomous provincial administration, they would benefit. The old complaint, again, of the initial inequalities as between provinces was stereotyped by this arrangement ; for the "realised surplus" of the provinces was no more than the result of the forced economy practised in war-time, which could not justly and advantageously be made the basis for a peace-time Budget, especially on the principles of Federal Finance.

The Meston Committee could not gainsay all these arguments. They, therefore, fell back on the fact of the improved resources of the provinces, which they estimated to aggregate Rs. 18·30 crores. They assumed that these additional resources were obtained at the cost of the Central Government,—a rather wide assumption, and they considered it but fair that the latter should

obtain some relief, at least temporarily, from these beneficiaries of their liberality. The Committee, therefore, recommended the following scheme of contributions from the individual provinces in and for the year 1921-22.

(*N.B.*—Figures are in lakhs of rupees).

Province.	Increased Spending power under the Reforms.	Contribution recommended by the Meston Committee.	Spending power left after the contribution was paid.
Madras	576	348	228
Bombay	93	56	37
Bengal	104	63	41
United Provinces ..	397	240	157
Punjab	289	175	114
Burma	246	64	182
Bihar and Orissa ..	51	..	51
Central Provinces ..	52	22	30
Assam	42	15	27

A glance at these figures would suffice to show that the arrangement devised was necessarily conditioned by the then existing circumstances; and that there was nothing in it to mark it as a scientific scheme of Federal Finance in practice. They claimed, indeed, for their recommendations the advantages, not only of preparing the provinces gradually for utilising their increasing resources,—without which preparation there might be the danger of indiscriminate and wasteful spending,—but also of paying due attention to particular needs, wherever possible under the guiding principle accepted by the Committee. Thus, in the case of Burma, the contribution was fixed so as to allow the largest margin to the provincial government, in view of the fact that till then the possibilities of the province had been neglected by the local government for want of adequate funds. In the case, again, of Bihar and Orissa, the Committee found :-

"The local government is quite the poorest in India, and very special skill will be required in developing its resources. Heavy initial expenditure lies in front of what is still a new province; and there is a wholly abnormal want of elasticity about its revenues. We cannot advise that any share of the deficit be taken from Bihar and Orissa in 1921-22; and we expect that the province will be sufficiently burdened by having to work up to its standard ratio of contribution in the same period as the rest of India." *

These contributions were, *inter se*, obviously unequal. While Madras, the United Provinces, and the Punjab contributed between them ¾ of the total estimated imperial deficit, Bombay contributed only 6½% and Bengal 5½%. But Bombay had a high scale of expenditure, which made the increase in its resources negligible. Bengal had relatively a low scale of spending; but then its revenues were inelastic. Moreover, both Bombay and Bengal contributed indirectly to the imperial revenues very much more than the other provinces; in the shape of the Customs Duties, and still more in the shape of the Income Taxes. The table no p. 111-12 from the Lecturer's woik on the *Wealth and Taxable Capacity of India*, though somewhat out of date now, is sufficiently true to the main trend of the argument to be significant for our present purposes.

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* *Cp.* The Meston Report, para. 18.

Revenue raised in the various provinces of British India for central as well as Provincial Government Account according to the Revised Estimates for 1923—24 *

Name of Province.	Revenues collected on account of Central Government.	Revenues collected on account of Provincial Government.	Total Revenue Collection.	Provincial expenditure.	Total Wealth of the Provinces.	Total Population.
	Rs.	Rs.	Rs.	Rs.	In crores of Rs.	
Baluchistan	23,96,000	..	..	..	..	..
N. W. F. Province ..	86,12,000	..	..	..	..	..
Madras	11,18,38,000	16,58,55,000	27,76,93,000	16,39,58,000	151.911	42,318,985
Bombay *	24,98,67,000	14,69,72,000	39,68.39,000	15,47,41,000	146.537	19,[illegible]48,219
Bengal	27,96,74,000	10,15,01,000	38,11,75,000	9,86,78,000	189.635	46,695,536
United Provinces	3,44,24,000	12,97,61,000	16,41,85,000	13,02,92,620	215.638	45,375,787
Punjab	2,76,09,000	10,29,10,300	13,05,19,300	10,59,95,500	99.373	20,685,024
Burma	7,98,64,000	11,37,08,000	19,3572,000	11,60,62,000	47.936	13,212 192
Bihar and Orissa	63,24,000	5,27,51,000	5,90,75,000	4,92,39,000	156.997	34,002,189
Central Provinces	96,67,000	5,26,07,000	6,22,54,000	5,24,07,000	80.851	13,912,760
Assam	43,93,000	2,20,54,000	2,64,47,000	2,15,58,000	44.915	7,606,230
India (General)	44,06,28,000	..	..	..	..	..
England	4,42,25,000	..	..	..	..	..
Exchange	2,01,03,000	..	..	..	..	..
Total Revenue ..	1,31,96,04,000	..	..	..	..	..

Incidence of taxation: rupees per head.	Proportion of the wealth of different provinces taken by the central and provincial tax collections out together.	Collection on Railways account.	On account of customs.	True yield of Customs.	Other Revenues.	Total Collection.	Proportion of 6 to 7.
		N.B.—The are in laksh of rupees and relate to 1921-22.		*N.B.*—The figures are in lakhs of rupees and relate to 1921 22.			
Rs.	Per cent.						Per cent.
..	..	..	..	..	..	..	..
..	..	..	..	..	..	..	..
6.30	18.26	1,131.1	158.66	280.00	2,453.93	4,023.69	26
20.51	27.18	1,214.4	173.42	550.00	2,333.17	4,170.99	28
[illegible].16	20.16	1,705.7	173.05	1,000.00	3,273.68	5,152.43	27
3.61	7.60	1,410.7	5.946	850.00	1,635.65	3,991.81	18
6.31	13.00	1,015.4	144.53	620.00	1,301.19	3,081.12	30
14.65	40.31	648.5	50.28	..	1,417.54	2,116.32	45
1.74	3.76	910.2	38.17	450.00	590.57	1,988.94	12½
4.47	7.70	520.6	47.03	120.00	614.64	1,302.27	16
			included	210.00	257.99	687.89	16
3.47	6.14	219.9	in Bengal.				
..	..	..	..	..	..	..	..
..	..	..	..	..	..	..	..
..	..	..	..	..	..	..	..
..	..	..	..	..	..	..	..

* These two tables are from the "Wealth and Taxable Capacity of India" by K. T. Shah and K. J. Khambatta, pages 283 and 288.

† The Bombay figures of revenue and expenditure do not include the development budget, which would add about 15 crores on either side, and so make the total tax-collections in Bombay amount to nearly Rs. 55 crores.

The *per capita* charge in that case would be Rs. 55 and the proportion of the provincial wealth taken by taxation would be 38 per cent.

These stable attempt to give as near a picture as possible, under the circumstances, of the exact burdens of the state borne by the citizen in the several British Provinces.

In view, however, of the general inequality of the contributions in the years following 1921-22, the standard contribution recommended by the Meston Committee had to be worked up to by the seventh year, at the rate of progression as in the subjoined Table :—

Name of † Province.	Year.						
	I	II	III	IV	V	VI	VII
Madras	35½	32½	29½	26½	23	20	17
Bombay ..	5½	7	8	9½	10½	12	13
Bengal	6½	8½	10½	12½	15	17	19
United Provinces	24½	123½	22½	21	20	19	18
Punjab	18	6½	15	13½	12	10½	9
Burma .. .	6½	6½	6½	6½	6½	6½	6½
Bihar & Orissa ..	..	1½	3	5	7	8½	10
Central Provinces.	2	2½	3	3½	4	4½	5
Assam	1½	1½	2	2	2	2	2½

To this the Committee added the soothing reflection that :—

> "If the Government of India fulfil their announced intention of gradually wiping out their deficit, against any increase in the proportion which a province will be called upon to contribute from year to year, there will be set off a reduction in the total to be contributed."

The scheme advised by the Financial Relations Committee, presided over by Lord Meston, was given effect to by what are known as the Devolution Rules,—a significant term in itself. We shall meet one or the other of these rules in later Lectures. Here we must notice Rule XVIII, which, after stipulating for the contribution, as thus fixed, in each province in each successive year, goes on to add :—

† Meston Committee Report, paras. 28-29.

"When for any year the Governor-General in Council determines as the total amount of the contribution a smaller sum than that payable for the preceding year, a reduction shall be made in the contributions of those local governments only whose last previous annual contribution exceeds the proportion specified below of the smaller sum so determined as the total contribution; and any reduction so made shall be proportionate to such excess.

Madras	.. 17/90ths.	United Prov.	.. 18/90ths.
Bombay	.. 13/90ths.	Burma ..	.. 6½/90ths.
Bengal	.. 19/90ths.	Central Prov.	.. 5/90ths.
Punjab	.. 9/90ths.	Assam ..	.. 2½/90ths.

These arrangements did not meet with any more approval from the provinces, than the main principles or the Meston scheme had done. The Government of India made concessions one after another; and at last, when their resources began by 1925-26 to permit them to do so, they proceeded to remit these contributions gradually, till, by 1927-28, all the contributions were completely remitted. The situation, however, is not even now all that it well might be expected to be from the standpoint of scientific federal financing; and it is not too much to hope that the constitutional revision of India now on the anvil will not fail to devote every attention it possibly can to this most vexed, most intricate, and withal most indispensable, problem of scientific financing as for a federation.

FINANCIAL FEDERATION IN REGARD TO INDIAN STATES.

Though the provincial finance, as it at present obtains in India, cannot be called strictly speaking, Federal Finance proper, there is yet a great deal in the arrangement which closely approximates it to the ideal of federalism. But the same can hardly be said in regard to the finances of the Indian States. From the earliest days of the relations of the Indian States with the British Government in India, the former have been treated as autonomous units, independent at least for purpose of their internal administration. The Indian problem, particularly in regard to the States and British India, is so utterly unique and peculiar that no known model elsewhere in the world can be said precisely to supply an analogy. We shall discuss these relations in outline, and endeavour to ascertain their guiding principles in the Lecture specifically dealing with the subject. Here it would suffice merely to observe that: though in the theory of international law, even in so far as it is applicable to these states in their relations with the British Government of India, they may be regarded as independent, autonomous units, there are Treaties, engagements, conventions and precedents which have insensibly brought the Indian States into ever closer relations, in an undefined way, with the Government of India. The progress of those visible bonds of the Railways and Canals, Roads and Telegraphs, binding the several parts of India close together in a common whole, has not been achieved without the absolute exclusiveness of the States from the British Indian system being at a number of points undermined, weakened, and finally broken down. The approximation to a federal ideal is, naturally, much more slender in the case of the Indian States than in regard to British Provinces. But that is sufficiently explain-

ed on grounds by no means intrinsically inimical to the ideal of a federation in India. While in the case of the British Provinces, with the exception of the three old Presidencies, all of them are creations of the Central government, the States have been mostly in existence apart from the British Government or its authority. While the Provinces, old as well as new, derive all their financial powers and authority by concession or grant from the Indian Government, the States have each an independent financial system of their own, even in cases where they are themselves the creations of the British Indian Government, *e.g.* Kashmere, or Mysore. Among themselves, again, while the Provinces are, so far, if not absolutely equal, at least comparable with one another in respect of size and wealth and population, the States *inter se* are so varied in area and revenues, and the consequent importance, that no uniform treatment of them is at all possible.

Given these conditions and peculiarities, it can be no matter of surprise that the position in India shows no approximation to a federal arrangement. The surprise rather is that, under these circumstances, and without anybody having expressly or consciously intended or desired it, the course of evolution has in fact shaped itself so as to embody unmistakable germs of a sound federal organism. It has been already remarked that the financial system of the States is, in each case, an independent unit by itself. Yet there are numerous points at which the States' financial systems, individually, as well as collectively, show links with the British Indian Financial system, which, if somewhat less than those exhibited by any typical recognised federal organisation, are yet much stronger and closer than those noticeable in the financial relations of any two wholly independent states. The earliest of these links, in point of time, were those

in regard to the Opium Treaties with the Central Indian or Malwa States, materially affecting the revenues both of the British Government and of the Indian States concerned. This leaves altogether out of account those treaties of Subsidiary Alliance, seeking to centralise the task of defence, which were concluded in the beginning of the nineteenth century with almost every important State; and which substantially affected the finances of the Company's Government, as well as of the States on the expenditure side. These treaties heralded the feeling of identity—or, at least harmony—of interests between the states and the Government of India, the logical conclusion of which could only be a progressive trend to federalism. The series of Treaties which had to be concluded in respect of the main as well as branch lines of Railways passing through Indian States territories drew these bonds closer; and those in regard to the salt sources in Rajputana,—which actually resulted in the Imperial revenues being materially, and even radically, affected by facilitating the abolition of the Inland Customs Line—may fitly be taken to set the seal of federalism on the Indian financial organisation, taken collectively. The treatment of the Customs and the Excise Revenue did not attract any very considerable attention, while the principles governing these sources aimed at the utmost freedom of trade, by the lowest rates of duties, on the fewest number of articles of commerce. There have been treaties between Indian States and the Government of India to regulate the levying of Customs duties; but these are either too old, or too insignificant. The principles, however, which these treaties embody; and the radically altered importance of the Customs Revenue in the Indian Budget as well as the new principles governing that Revenue, have, in recent years, attracted very considerable

notice and discussion, which must inevitably lead in the same direction of Federalism. And this discussion must rebound on other sources of revenue as well as expenditure, the final solution for which all will not be found except in the consummation of the principles already at work. On the side of expenditure the function of Defence is practically centralised. Some Indian States still maintain their own armies; but the real defence value of these units is apt to be exaggerated by these States. On the whole, the analogy of Germany may well be quoted in this connection, if only to point out that the points of contact between the several independent and autonomous German States in the nineteenth century, until the achievement of a federation in that country in 1866—70, were by no means greater or more numerous than are already noticeable in India. The same force of circumstances seems to be pressing upon our several governments, which must eventually compel them to seek salvation in federation. The Government of India enjoys, it is true, an entrenched position in many particulars, which is hardly parallelled in any other country. But the history and importance of Prussia in North Germany before the Wars of 1866 and 1870 may well be instanced to emphasise the modern and inevitable trend of development even in regard to this country. The Provinces will, for their own reasons force the Government of India to adopt financial federalism in a more liberal measure than ever before. And the rearrangement on federal lines, whatever it be, will be neither complete, nor logical nor satisfactory if it leaves out the States.

The position of Municipalities and othe purely local governing bodies is omitted, because in any likely scheme of federation which we can envisage to-day, these will be regarded as mere delegates of provincial governments,

not entitled to rank on a par with them. Personally, I think the provinces are anomalous and heterogeneous to such an extent that we may well regard them as being the fifth wheel of the coach. Hence the demand for a redistribution of the existing provinces on a line of division which will assure some measure of homogeneity in each such reconstituted province. It is probable that in such a scheme of reconstruction, the principal cities of India will have to be made into independent, autonomous, equal units with the provinces. And the reasoning which brings about such a rearrangement may, if carried to its logical conclusion, dispense altogether with the provincial governments-making the entire country consist of a close federation of a large number of municipal and district units. This may also help to solve the problem of the varying size and wealth of the Indian States. But whether or not that consummation is reached, for the moment, I think, we must consider the provinces and States to be accomplished facts. which must be reckoned with in any proposal for federation.*

SUMMARY.

Further consideration of this topic must be postponed until we have reviewed the financial position of India, the Provinces, and the States. Here let us briefly sum up the salient features of the Indian Financial organisation in principle and practice :—

(1) There is, as yet, no absolute, clear-cut, logical division of resources and obligations, even as between the Provincial Governments and

* Cp. on this for subject of the place of Municipalities in a federation, an article by the present writer under the same title in the *Calcutta Municipal Gazette* of November 17th 1928.

the Government of India, following an equally clear-cut division of powers and responsibilities.

(2) Such division as has already been made is not in accordance with any well thought out, co-ordinated, scientific principles of federal financing, but rather the growth of past history and convention that is rapidly becoming a misfit for our altered conditions and ideals.

(3) Whether or not an absolutely clear-cut division of resources and obligations is possible, the Indian States can no longer be left out. The final arrangement, whatever it is evolved to be, will have to be tripartite as between the Government of India, the British Provinces and the Indian States, the interests of all these being considered to be essentially identical, and so secured equally in a well-planned and co-ordinated system.

LECTURE III.

Review of the Public Revenues in British India.

I *Division between Imperial and Provincial: Progress of the aggregate.*

The public revenues of the Central and Provincial Governments in British India are reviewed in this Lecture, with a view, by an analytical examination of their sources, to determine which of the sources are best suited to be federal items of revenue, and which provincial. I have avoided the alternative method of considering the central finances apart from provincial finances, not only because that method would not yield quite the result we must have, but also because it is likely to emphasise needlessly a sentiment of rivalry or jealousy as between the several provinces, which we cannot do too much to avoid.

The public revenues of British India, since the constitutional Reforms of 1920, show the following Progress :—

* Year Accounts.	Imperial. Rs.	Provincial. Rs.	Total. Rs.
1921-22 ..	1,15,21,50,317	70,43,03,736,	185,64,54,053
1922-23	1,21,41,29,156	75,73,85,238	1,97,15,14,384
1923-24	1,32,78,64,527	78,85,09,389	2,11,63,73,916
1924-25	1,37,53,18,119	81,28,18,082	2,18,81,36,201
1925-26	1,33,17,30,492	87,51,20,130	2,20,68,50,622
1926-27	1,31,69,99,799	86,43,15,858	218,13,15,693
1927-28 Revised Estimates.	1,27,73,98,000	90,99,54,742	2,18,73,52,742
1928-29 .. Budget Estimates.	1,29,64,75,000	91,12,61,000	2,20,77,36,000

* These figures are taken, upto 1926-27, from the *Decennial Statistical Abstract for British India* (1917-18 to 1926-27) and thereafter from the individual Budgets. Only nine principal provinces are included in the last four years.

For purposes of effective comparison, the period since 1921-22 is the only suitable one, as the new principles of India's constitutional organisation have come into practice only since that time. To those who would study the organic growth of the problem as a connected continuous process, the account in the preceding Lecture would serve as an introduction at least. The choice of period is not intended to suggest that the past is not worth studying.

Before considering these figures from a federal financial standpoint, let us note that the figures of the Imperial Indian Revenues include only the net revenue from the so called Commercial Services under the Government of India, *viz.*, the Railways and the Post Office. The working expenses for these services are deducted from their gross receipts; and the Indian Budget, therefore, takes cognisance only of the surplus. The total revenue and expenditure figures in the Imperial Budget would, therefore, have to be increased, in round figures, by 80 crores before the student can have an accurate idea of the volume and proportion of these revenues and expenditure. Since the separation of the Railways Budget from the ordinary Budget of the Government of India in 1925-26, the latter only gets the benefit of the net contribution from the Railways to the public purse; but for purposes of accounting, the credit taken in the Imperial Budget on the Railway Revenue Account includes also the interest &c. on Railway account paid by and through the Government of India.

The changes in the aggregate, both in the provincial and the Imperial, revenues are considerable and noteworthy. The aggregate of the combined account shows a growth, which may well be taken as the just measure of the revenue expansion of the country collectively considered. We do not make any allowance for the variation in the exchange

value of the standard money of the country, which in reality, must have substantially affected the financial position. At the beginning of the period, the standard of money in the Indian Empire, the Rupee, was valued by law at 2 shillings in exchange with English money, as against the pre-war ratio of 16*d*. to the rupee. But in 1927 the legal ratio in exchange was fixed at 18*d*. per rupee. The actual exchange value of the rupee had fluctuated considerably; but from the beginning of the period here reviewed it had tended to approximate to 16*d*. gold. How far these changes in the official ratio of exchange, and variations in the actual purchasing power, of the rupee affected the budgets of the Central as well as the Provincial Governments, it is not the purpose of these Lectures to enquire. Mention, however, has been made of this factor at this stage for reasons which would be obvious in the course of the series.

The only common link between the Imperial and the Provincial Budgets was, while it lasted, that of the Provincial contributions. Entries there are in every Budget of miscellaneous adjustments between the provinces and the Government of India; but, apart from the Provincial Contributions, these do not materially affect the real financial position. When the Imperial Government's finances began to improve since 1925-26, the provincial contributions were progressively remitted as promised. This is one explanation of the variations in the figures of revenue in the provinces and in the Government of India. What the Government of India sacrificed in this regard, the Provinces have gained, though not, of course, all in the same degree. The Provincial contributions amounted at their maximum to about 10 crores, which, being removed from the high-water mark of the Central revenues in 1924-25, shows a net fall in those revenues of less than 8 crores as

between the accounts of 1924-25, and the Budget Estimates of 1928-29. The improvement in the aggregate Provincial revenues during the period is over 20 crores. This is partly an indication of either additional taxation in the provinces, or of an improvement in the existing sources. As we shall see later on in this Lecture, there has, no doubt, been some additional taxation, either in the shape of new taxes from among those allowed to the provinces, or in the form of increased rates in existing taxation. Improvement in the existing provincial sources of revenues at the same old rates is relatively insignificant ; and in individual cases there has been a decline also, due either to the accepted policy, *e.g.* in regard to the Excise Revenue, or to a readjustment of revenues *inter se.*

In the case of the Imperial Budget, there have been noteworthy sacrifices, besides that of the contributions from the provinces. They include abolition of the cotton Excise Duty, (Rs. 2 crores) reduction of the salt duty (3 crores) and readjustments in the Customs Schedule and reduction in the Income Taxes as also reduction of railway rates and fares. The general depression in trade has also affected the imperial revenues, even more prejudicially than in the provinces. Nevertheless, there has, on the whole, been a steady improvement in the revenue position of the Central Government, due chiefly to better administration and some stabilising factors set into operation for the benefit of imperial finance. There is, for example, the concealed taxation in the increased exchange value of the rupee, which makes substantial savings in respect of the " Home charges " of the Government of India. The Imperial Government has also received some windfalls, in the shape, for example, of the proceeds of the enemy ships sold during the War. But these have been spasmodic, and d have been more than swallowed up by the

sacrifices above named. The aggregate improvement, therefore, must be ascribed to better administration. Customs and the Railway Revenue despite readjustments have been the main contributories to this improvement, which promises to be lasting. The revision of the entire Indian revenue system with a view to its scientific organisation has been long overdue; and actually a committee of experts have reported on the subject during this period. If the revenue position shows a substantial improvement, in spite of this shortcoming, the prospect cannot be held to be too gloomy. And when the readjustment of the entire revenue system takes place, in due correlation with expenditure requirements, it may reasonably be expected the distribution of revenue resources between the Imperial and Provincial Governments would be similarly revised and recast.

The relative proportion between the Imperial and the provincial governments is also noteworthy. Taking the Imperial revenues in the way they are now given, the provincial revenues, even at their present improved level, are in the proportion of 9 : 13, or about 41 per cent. of the total revenues of British India, while the central Government claims over 59 p.c. This compares not very unfavourably with the position of the States' finance in some of the other great federations of the world as shown by the following table:—

(Revenues in million.)

Country.	Central or Imperial.	P. C. of Total.	States' or Provincial	P. C. of Total.	Total.
United States . $	4,129.30	66.5	2,078.53	33.5	6,207.92
Germany Mks.	8,147.9	81.0	1,907.35	19.0	1,00,55.25
Australia. £	72.28	41.6	101.42	58.4	173.70
Canada $	398.695	74.0	143.975	26.0	542.670
Union of South Africa £	25.336	73½	9.201	26½	34.537

[1] Percentage of Total Tax Revenue.

The percentage of Imperial or Federal revenues is the highest in Germany, and the lowest in the Australian Commonwealth. The tendency, however, seems everywhere to be to increase the central revenues, if not uniformly at the expense of the local or provincial revenues, at any rate by devising additional means of income. The normal .position, morever, seems to leave to the federation far larger margin of revenue resources, usually from 2/3 to 3/4 of the total public revenues in each federal state, than to the federated units, which, among them collectively, get from one-fourth to one-third,—some times much less,—of the aggregate income of the State. This is as it should be, since the federation is formed to promote most effectively the material interests of the community; and that cannot be achieved without adequate resources. On the other hand, the no less urgent and far more abiding problem of social reform and reconstruction on more human and equitable lines,including a gradual if indirect redistribution of the wealth of the community, must be left to the provinces. And these, in their turn, demand ever expanding revenues. Whether it is the problem of universal education in the state, or of relief of destitution, or provision of industrial insurance, old age pensions, unemployment doles,--the task must necessarily be left in a federation to the constituent states. The federal authority may in all these and like matters lay down, at most, general principles for the guidance of the administration; but the actual administration must be left to the provinces. The Indian experience in regard to the relief of Famine, ever since the beginnings of the idea of decentralised finance, furnishes a model worth considering. The German precedent, on the other hand, of extreme centralisation may be discounted, in part at least, as being due to extraneous circumstances of a purely international

political character. When the forces of the moment disappear or weaken, Germany may be trusted to revert to the standard pattern of federations, in which all these services, and the corresponding resources to supply them, will be claimed by and allowed to the states making up the federation, and not to the federation collectively.

In regard to India, the combined revenue position of the Central and Provincial Government is represented in the following table :—

Statememnt of Revenue Actuals for 1926-27.

(*N.B.*—The figures are in thousands of rupees.)

Principal heads of Revenue.	India.	Bombay.	Central P.	Bihar & Orissa.	Punjab.
	Rs.	Rs.	Rs.	Rs.	Rs.
Customs	47,38,10	..	..	..	..
Salt	6,69,81	..	..	..	..
Opium	4,33,13	..	..	..	..
Tributes from Indian States	83,52	..	..	..	..
Taxes on Income ..	15,64,96	..	2,17	3,24	4,02
Land Revenue ..	41,00	4,66,95	2,32,87	1,69,21	3,21,26
Excise	411,32,17	4,09,39	1,35,45	1,97,34	1,24,31
Stamps	26,68	1,67,57	61,45	1,07,12	1,13,27
Forest	23,57	76,56	53,21	8,44	39,08
Registration ..	1,57	12,04	6,47	15,42	9,11
Scheduled Taxes ..	..	19,55	..	..	..
Total ..	..	11,52, 06	4,91,64	5,00,79	6,11,05
Irrigation and Navigation (including local railways) ..	10,25	49,24	1,59	24,24	3,79,79
Debt Services ..	4,08,59	1,68,13	2,48	9,32	8;79
Civil Administration	86,05	59,10	20,15	25,50	45,50
Civil Works ..	15,78	16,38	5,10	6,49	4,89
Provincial Contributions and miscellaneous adjustments between Central and Provincial Governments	5,17,75	4,03	7	37	..
Extraordinary items	60,10	2,58	4,52	..	94,69
Railway Revenue ..	34,07,08	..	..	..	..
Miscellaneous ..	60,01	34,54	7,67	7,22	26,72
Currency & Mint ..	86,05	..	..	..	..
Military Receipts ..	4,94,68	..	..	..	..
Total Ordinary Revenue	1,31,69,9	914,86,06	5,29,50	5,73,96	11,71,43

N.B.—The above accounts of the provinces are taken from the Budget statements of the respective provinces for 1928-29.

(*N.B*—The figures are in thousands of rupees).

Principal heads of Revenue.	United P.	Burma.	Madras.	Bengal.	Assam.
	Rs.	Rs.	Rs.	Rs.	Rs.
Customs	..	..	..	..	..
Salt	..	..	..	..	..
Opium	..	..	..	..	..
Tributesfrom Indian States	..	..	..	..	..
Land Revenue ..	6,87,97	5,22,93	7,54,31	3,11,18	1,06,72
Excise	1,30,99	1,32,88	5,10,52	2,25,17	71,93
Stamps	1,69,29	65,83	25,23,07	3,31,60	23,56
Forest	52,28	2,17,35	56,24	31,24	31,67
Registration ..	13,31	6,38	40,52	38,50	2,28
Scheduled Taxes ..	..	..	..	16,91	..
Total ..	10,53,86	9,59,71	16,18,55	9,54,60	2,41,08
Irrigation & Navigation (including local railways) ..	1,00,18	23,84	—41,05	1,37	7
Debt Services ..	9,23	11,68	20,86	4,11	1,01
Civil Administration	44,84	47,77	60,24	74,02	8,54
Civil Works ..	3,92	13,12	8,37	6,03	4,30
Provincial Contributions & miscellaneous adjustments between Central & Provincial Governments	..	..	..	..	5
Extraordinary items	30,54	3,20	..	..	..
Railway Revenue ..	..	..	..	..	..
Miscellaneous ..	41,11	69,25	16,70	20,22	3,34
Currency & Mint ..	..	..	..	..	..
Military Receipts ..	..	..	..	..	..
Total Ordinar Revenue ..	12,89,70	10,56,27	16,83,68	10,50,36	2,58,49

N.B.—The above accounts of the provinces are taken from the Budget Statements of the respective provinces for 1928-29.

Considering these sources *seriatim*,—and taking the Imperial side first,—we find the Customs Revenue to be the most considerable single item of the aggregate Indian revenues. Its present importance is only a post-war creation ; and the principles which now govern it * are likewise of recent evolution. But even now the customs revenue of India must be pronounced to be the result mainly of a tariff adjusted for reasons of securing a growing revenue. It consists of duties both on imports,—including raw materials and

* Percentage of Total Tax Revenue.

Tax Head.	1883-4.°	1893-4.°	1903-4.°
Land Revenue	53.15	46.71	42.76
Customs	2.98	3.27	9.21
Excises	25.07	26.51	24.97
Income Tax°	1.32	3.39	2.92
Transactions and Fees° ..	9.47	9.59	9.39
Probate Duties°	..	..	..
Local Taxation (Capitation Tax. etc.) ..	8.01	10.53	10.75

°Tax Head.	1913-4.°	1923-4.°	1928-9.°
Land Revenue	35.42	20.75	24.0
Customs	12.99	24.30	33.5
Excises	22.92	21.67	17.5
Income Tax°	3.52	12.30	11.5
Transactions and Fees° ..	10.89	9.03	13.5
Probate Duties	0.18	0.15	00.0
Local Taxation (Capitation Tax, etc.)° ..	14.08	21.70	..

* The subjoined table is taken from the Report to the Taxation Committee and is highly suggestive. The definition of a Tax-head is, of course, that of the Committees own, for the years upto 1923.24. For the last column we have left out of account the figures of local taxation. The proportion is to that extent incomparable.

manufactured articles,—and exports; and among the latter may be our natural monopolies, like jute, or others like tea, or rice, or hides. The protectionist influence is no doubt at work; but in very few cases, and these not of the most considerable in the volume or the value of trade. The duty is paid, indirectly of course, by every citizen of India, whether resident in British territory or in the Indian States. And this constitutes one of the gravest peculiarities of the Indian financial system. The problem of the Customs Revenue adjustment and redistribution, complicated particularly by the demands of the Indian States in that behalf, will be discussed more fully in the Lecture dealing with the Indian States' finances. Here it is enough to add that, normally, the Customs Revenues are an exclusively federal item of public income in all modern federations, though local taxes on the import or export of goods within local boundaries —in the nature of purely inspection fees, or consumption taxation of very small incidence,—is allowed to the constituent units in many cases. The federation, however, is forbidden, usually, the levy of any duty on the exports from any state within its jurisdiction; and also any invidious discrimination, as regards interstate commerce, between one state and another. Transit duties are, similarly, rigidly prohibited, either to the constituent states, or to the federation, in the obvious interest of internal trade and economic development; though port duties by port authorities, and non-refundable terminal taxes by municipal bodies are getting into vogue.

In all these respects, the Indian Customs revenue shows one or the other peculiarity, which makes our problem more complicated than anywhere else. Contributing to-day some 50 crores, in round figures, out of a total net imperial revenue of 130 crores in round terms, the Customs Revenue

is naturally the most important single item in the Budget, and its main prop. Its importance is enhanced by its contribution in the economic development of the nation, while its political significance is emphasised by the increasing intensity of the claims of the Indian States for a share in this revenue. As between the different provinces, the share of the Imperial Customs revenue contributed by each is all but impossible exactly to determine, though a comparative table elsewhere in these Lectures has made the attempt at an approximation.* The provinces, however, cannot have the same grievances, *inter se*, in regard to the monopoly of the Customs revenue by the Imperial Government, as the States might plausibly urge. But if the Customs revenue operates to tax a considerable portion of the wealth of a single province, in contradistinction to the others,—*e.g.* the export tax on Jute from Bengal, Tea from Assam, or Rice or Petroleum from Burma,—that province might legitimately ask for special compensatory treatment. We shall notice such claims when we come to discuss the provincial revenues. But we must notice here the recommendation of the **Taxation Enquiry Committee** in regard to Export Duties :

> "On the whole, it may be said that export duties provide a possible balancing factor, but one to be employed only in the last resort." †

The committee's recommendation is, of course, in connection with their general scheme of tax-reform and readjustment, which includes internal redrafting of the Customs schedule involving considerable remission or reduction. In some cases, by a majority if not unanimously, they recommend

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* Cp. *ante* p. 111-12.

† Cp. para. 522 of the Report of the Taxation Enquiry Committee p. 377.

even an addition to the list of export duties, *e.g.* on oilseeds. From the point of view of distribution of revenue resources among the constituent units of a federal state, their suggestion about making export duties a balancing factor is, however, seriously open to question, for reasons of which they themselves are by no means unaware. They have themselves opined :

> "It is undesirable for both Imperial and Provincial Governments to be interested in a tax of the nature of an export duty, since such an interest renders it doubly difficult for the trade concerned to secure amelioration when it is due." *

The particular consideration prompting this reflection is very narrow. The proposition cannot, indeed, be universally accepted that the main, if not the only, purpose of an Export Duty is to benefit the industry taxed by devoting the proceeds of that tax to that purpose. Such an appropriation or ear-marking of particular revenues in advance militates against the principle of the integrity and solidarity of a state ; and tends to engender vested interests which cannot but be condemned. But even apart from the interests of a given industry, the general economic principle governing the imposition of an export duty—in unitary as well as federal states,—is too sound to be safely neglected. Export duties can only be levied advantageously on the natural, practical monopolies of the exporting and taxing country, as jute is in India ; and then, too, for revenue purposes only. The admixture of a prot ionist element in such a duty,—*e.g.* the suggested duty on the exports of oil-seeds from India, or on cotton —is, while not absolutely inadmissible or invariably injurious, liable to be abused, and calculated to create recriminations between the federal and the

* Op. cit. Ibid.

provincial authorities, which cannot be avoided too rigorously. Taxation of exports, particularly of raw materials or accessories of industry, can only be beneficial in a protectionist regime, if, side by side with the taxation of such exports, measures are adopted effectively to promote the manufacturing industry in which such exports would be required. The export duty on hides, for example, has not proved a success in India, mainly, I think, because no steps were simultaneously adopted to promote the leather industry in the country. By taxing our exports of this material, we only lost a good market for our produce, without in any way benefiting our labour or capital, as we might have —had we taken steps at the same time effectively to promote leather manufacture in India. Even in the case of the export duty on raw and manufactured jute, except for the revenue derived from that source, we cannot claim the tax to have been a success from the stand-point of developing an industry. It is true, the financiers of the Indian Government have never contemplated this particular taxation from any other stand-point except revenue,—even by way of an *arriére-pensée*—such as might have been intended by a protectionist financier seeking to develop the manufacturing of this particular product to the full extent of our productive capacity in that material. But that is no reason to overlook the implied *rationale* of such a statement as that of the Taxation Committee quoted above, which aims at using part of the proceeds of such taxes for developing the industry concerned. Subsidies may, for example, be directly granted to promote such an industry. In this way intensive protectionism may embrace almost every raw material of industry, of which the taxing country produces a considerable proportion of the world supply. But unrestricted protectionism of this kind will, in a federal organisation, be soon

brought up into sharp conflict with the economic interest of the producers of such raw material, and the financial interests of the local governments of those areas—not to mention the additional conflict of interest between the manufacturers and the producers of the raw materials. The conflict in the case of India is likely to be much sharper than that in any other federation, given the variety of interests and jurisdictions; and hence the unwisdom of the suggestion of the Taxation Committee.

Next in order of importance to the Customs Revenue in the Imperial Indian Budget, is the item of the Taxes on Income, comprising a moderate graduated tax, on non-agricultural incomes, over Rs. 2,000 per annum; a super-tax on incomes exceeding Rs. 50,000, and a flat rate of taxation on the profit of Joint-stock Companies, which is very similar in its nature to a Corporation Tax. The taxation of incomes differs, in almost every material particular, from the Customs Revenue. While the latter is an indirect,—and therefore often an unperceived burden,—the former is a direct tax *par excellence*. While the graduation and adjustment of Customs Duties provide endless occasions for an admixture of motives other than those of securing a revenue, the taxes on Income and property have one unique aim: Revenue. Customs Revenue, no matter how and why levied, is in all federal states a central income; but, at least in theory, the direct taxation on the wealth or income of the citizens is preferably entrusted to the constituent states. True, the inroads of the federal exchequer on this once jealously guarded source of state revenues are growing rapidly; and to a degree that practically amounts to an ousting of the state jurisdiction from this once its close preserve. True, likewise, the motives in many countries for the prevailing heavy taxation of income and property are not exclusively those of revenue collection,

though it may be that in federal states the revenue motive is still the most predominant. But, when every allowance is made for these features, the fact must be recognised that taxation of income and property is peculiarly suitable for the component states of a federation. For one thing, it an excellent means of stimulating effective interest in public administration among the governed. And the source or object on which the tax falls is, generally speaking, fixed, often irremovably, to the territory in which it is situated. Hence the practice of the earlier federations to assign direct taxation to the constituent states and indirect to the federation.

It is true, of course, that with the growth of modern forms of personal and movable property, the old argument on behalf of the constituent States in a federation reserving for themselves this source of public income becomes weak. Under modern conditions of large scale industry, and nation-wide diffusion of branches of a highly centralised business in more than one state of a federation ; or under conditions wherein, while the owner of a profit-making enterprise may be in one state, its profit-earning business or assets may be in another,—thereby giving rise to the problem of avoiding double or over-lapping taxation by several authorities ;—the argument is becoming increasingly unanswerable in favour of the federal authority reserving these taxes for itself. The states making up the federation are compensated for this sacrifice by means of subsidies from the central purse inflated by the proceeds of direct taxation. Or they are allowed to levy additional direct taxation on their own account. This embodies, very possibly, the explanation of the seeming anomaly in the existing financial arrangements in India, which makes the Revenue from land a wholly provincial item in spite of its being a direct tax *par excellence*;

and makes the taxation of incomes an Imperial item. Says the Montagu-Chelmsford Report on the *Constitutional Reforms in India*, and in regard to the Income-Tax.

> "We see two very strong reasons for making this an Indian receipt. First there is the necessity of maintaining a uniform rate throughout the country. The inconveniences, particularly to the commercial world, of having different rates in different provinces are manifest. Secondly, in the case of ramifying enterprises with their business centre in some big city, the province in which the tax is paid is not necessarily the province in which the income was earned. We have indeed been told that income-tax is merely the industrial or professional complement of the land revenue; and that to provincialise the latter, while Indianising the former, means giving those provinces whose wealth is more predminantly agricultural, such as the United Provinces and Madras, an initial advantage over a province like Bombay, which has very large commercial and industrial interests. Another very practical argument is that the tax is collected by the provincial agency, and that if provincial governments are given no inducement, * * * there will be a tendency to slackness in collection and a consequent falling off in receipts. We admit that these arguments have force; but we are not prepared to let them stand in the way of a complete separation of resources.'"*

They were obsessed, unduly in my judgment, by the mischief of the so-called "divided heads" of revenue, divided as between the Imperial and the Provincial Governments. In their search for a complete separation of resources, they refused to be swayed unduly by considerations of equalisation as between provinces, so far at least as to equalise every item of revenue. It was, of course, impossible to argue, while the Provincial Contributions continued, that a complete separation of resources had been attained; and even after the complete extinction of these contributions, the severance of the two schedules of revenues is by no means

* Op. cit. para. 203.

perfect. The Meston Committee on the adjustment of financial relations, consequent on the Constitutional Reforms, had to accept the governing principle as laid down by the authors of the Constitutional Reforms; and so they had no option but to assume the Income Taxes as in Indian Imperial source of revenue. But when they came to give effect to these Reforms and recommendations, they found that the injustice as between the provinces by the complete Indianisation of the Income Taxes was so great as to demand a modification. Hence the evolution of the Devolution Rule XV:

> "Whenever the assessed income of any year subsequent to the year 1920-21 exceeds in any Governor's province or in the province of Burma the assessed income of the year 1920-21, there shall be allocated to the local government of that province an amount calculated at the rate of 3 pies in each rupee of the amount of such excess."

This, however, brought no real relief—nor made for a more equitable adjustment—as between the several provinces, as is but too clearly evident from the subjoined table—

Taxes on Income.	1921-22.	1922-23.	1923-24.
India	1,02,79,403	1,00,24,120	95,47,620
Madras	1,77,72,996	1,32,22,921	1,70,71,299
Bombay	8,76,30,086	7,88,53,144	5,34,35,749
Bengal	6,58,22,278	3,25,25,167	6,03,19,439
United Provinces..	1,22,04,515	98,32,271	89,17,763
Punjab	57,11,874	75,54,302	72,09,384
Burma	1,50,74,902	1,55,08,033	1,48,22,749
Bihar & Orissa ..	40,86,210	58,82,328	47,36,685
Central Provinces .	56,52,984	59,92,853	57,82,887
Assam	8,35,879	9,16,178	14,37,366

Taxes on Income.°	1924-25.	1925-26.	1926-27.
India	91,04,478	96,23,623	1,07,58,640
Madras	1,31,56,365	1,41,38,701	2,02,44,138
Bombay	4,03,77,094	3,50,49,017	3,22,17,760
Bengal	5,54,73,933	5,93,60,314	5,55,07,491
United Provinces..	78,87,089	80,53,797	71,49,213
Punjab	60,67,102	65,23,275	66,67,445
Burma	1,78,33,454	1,86,39,974	2,05,87,674
Bihar & Orissa ..	41,46,926	37,05,441	57,73,617
Central Provinces .	50,85,167	36,14,187	39,48,984
Assam	23,79,560	19,04,040	34,41,321

Viewing the entire scheme of the division of resources as a whole, the reflection is unavoidable, —and the Meston Committee on Financial Relations were themselves the first to record it,—that, in view of the peculiarities of the Indian Income Tax, which is charged only on non-agricultural incomes, and considering the wholesale provincialisation of Land Revenue, it would be impossible permanently to keep out the provincial governments from some form of direct taxation upon industrial and commercial earnings within their own jurisdiction. In other federations, where direct taxation of all income—agricultural or non-agricultural—is practised by the federal authorities, the States Governments either levy an income tax of their own distinct from that of the federal Government, as in the United States, Australia, or Canada ; or, on the standard uniform income-tax levied by the central government, an additional percentage is imposed

for the benefit of the several provinces, as in France; or a definite proportion of the same common income-tax receipts received by the federal government might be allotted to the several provinces. The first alternative, however, would intensify the evil of overlapping taxation by more than one authority, and the second device is applicable only " where the income tax machinery is directed to taking, either by reference to the source, or by reference to the destination of the income, and not where a combination of both methods is adopted."* The third alternative, the least troublesome, if we could only agree to on the governing principles according to which division should be made. The American devices, moreover, of special corporation taxes, or " Franchise " taxes; or the General Property Tax, or even the increased Death Duties, do not seem to be practicable in India, for the same reasons that made the Income Tax initially an Indian item. In regard, however, to property,—personal as well as real,—which is fixed in one province only, there is no reason why a tax on such property,—on sale, or transfer, or succession,—should not be imposed by the Provincial Governments, if the latter find their other resources inadequate to their irreducible requirements. The question, indeed, of a double incidence of taxation might affect this arrangement seriously. There are forms of wealth, income or property, whose " economic allegiance "—to use a phrase adopted by a Committee of international experts on this very problem—is impossible to determine exactly, especially with reference to the conflicting claims of origin of the income, or the domicile of its receipient where the two are not identical. The Committee above referred to made a working classification of the undermentioned forms of wealth, according to whether the origin

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*** Taxation Inquiry Committee Report para 532.**

of the income or the domicile of its receipient was the preponderent principle. In the classification A represents the country in which a corporation or deed, or vessel is registered, B where the taxation of the property is proposed, and C where the taxation of the income from the given source is in question.

Category of Wealth.	PREPONDERANT ELEMENT.	
	Origin.	Domicile.
I Land	*	....
II (a) Mines, Oil, Wells, etc.	*	....
II (c) Commercial Establishments°	*	....
III (a) Agricultural°	*	....
III (b) Machinery, Flocks and herds, Money, Jewellery Furniture ..	....	*
IV Vessels	A*	....
V (a) Mortgages	B*	°C*
V (b) Corporate°shares ..	....	*
V (c) „ Bonds ..	....	*
V (d) Public securities ..	....	*
V (e) General Credit ..	....	*
VI Professional Earnings° ..	....	*

* Quoted from the Report of the Taxation Enquiry Committee para. 535. For the foregoign classification cp. *Ibid* para. 534.

The general principle adopted by the Committee of experts runs :—

> "On the subject of Income taxation in its developed form, the reciprocal exemption of the non-resident is the most desirable practical method of avoiding the evils of double taxation, and should be adopted whereever countries feel in a position to do so."*

The Taxation Committee appointed by the Government of India, while accepting the general principle as above, overlook in their practical recommendations, the most considerable complication peculiar to India. They have made varying, not unanimous, and by no means satisfactory, recommendations as regards the taxation of non-residents in a country on incomes derived by them from that country. The majority would, generally speaking, "leave things as they are"* though Dr. Paranjapye—one of their members,—saw no reason why incomes arising in India of people not resident in India should not be taxed by India, whether the income in question was in the form of leave salaries and pensions of Indian public servants domiciled abroad, or interest on sterling debt, or profits of foreign business corporations with branches in India. Thanks to the device of charging the income tax at the source, the tax on Government securities, as well as shares or bonds in industrial or commercial companies in British India, is deducted before payment is made to the holder of these securities, irrespective of whether the holder is a resident in British India or in the Indian States. While most foreign holders of Indian securities or salaries, not resident in India, are exempted from the Indian Income Taxes, Indians, not resident in British territories, are nevertheless taxed. This is an anomaly, which cries urgently for correction, the more so as exemption from such taxation is not allowed to the holders

* Report para. 231.

of British Indian securities, even when such holders happen to be Ruling Indian Princes. The problem is not only a matter of revenue to this or that government, though even the revenue involved is not inconsiderable; the problem affects much more vitally the flow of capital, which all parts of India badly need for economic development. As the most enlightened among the Ruling Princes seem at last to have realised the wisdom of economic investment, the parties affected are vitally interested and have strong arguments on either side of the border line. The Taxation Enquiry Committee do not seem in their report to have considered this aspect of the question at all. And so they have overlooked the wise suggestion of the Committee of International Experts (Profs. Bruins, Einaudi, Seligman and Stamp) which is thus paraphrased by Prof. Pigou in his recent work on *Public Finance* :—

> ' As between countries neither of which is predominantly debtor or creditor to the other, each should agree to exempt from taxation income originating in itself but accruing to the citizens of the other, and to tax only income accruing to its own residents, no matter where that income has its origin. As between one country which is predominantly a debtor and another which is predominantly a creditor, this arrangement would not however, work out equally. The debtor country would be required to surrender much more revenue than the creditor country; for there would be much more income originating in its borders and accruing elsewhere. The League of Nations experts, therefore, suggest that in these cases conventions should, as before, be made for the mutual exemption of income passing out to non-residents; but that in order to prevent this bargain from affecting the contracting states unequally, appropriate compensation should be paid to the governments of those which would lose by it by the Governments of those which would gain."*

Even in Britain, the home of this principle of charging the Income Tax at the source, under

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* Pigou: *Public Finance*, p. 192.

a recent Act of Parliament, incomes of British residents from investments in British Dominions are charged the British tax at only half the current rate, so as to avoid double taxation and promote inter-imperial investment. The Indian Taxation Enquiry Committee, considering the problem of the Income Tax as only between the Central and the Provincial Governments in British India, recommended that the provinces be given "the proceeds of a basic rate on personal income graduated proportionally to the general rule," while the entire tax proceeds on incomes not appertaining to residents in any particular province they would give to the central government, as also all the super-tax yield. They would also allow the provinces a small share in the Corporation Profits Tax, distributed on the basis of collections under this head in each province. But all these are mere adjustments, which may not solve the main problem of a satisfactory distribution of the revenue resources of the country among its several governing authorities, so as to be adequate to the needs of each, and at the same time avoid any overlapping. The balancing factors named by the Taxation Committee amount only to disguising the present connecting links. Further consideration of the problem must, however, be postponed until after we have reviewed the Indian States finances.

The next item of importance in the Imperial Indian Revenues is Salt. It is in the nature of an Excise Revenue, an indirect tax, paid by every citizen in India, irrespective of the jurisdiction he lives under. The economics of levying the salt duty need not concern us here. But inasmuch as the salt revenue has come to be standardised throughout India by the conclusion of Treaties with certain Indian States, which are the most considerable producers of the salt used in India; and because, in virtue of these Treaties, the salt

tax is now made to fall on the subjects of the Indian States as well as of British India, the political question is one of the most complicated in connection with the proceeds of the salt revenue. Not all the Indian States are salt producers; but all their subjects have to bear the British Indian Salt Tax, whose manipulation of rates lies entirely in the hands of the supreme Government of India, and which is effected according to considerations relating to the finances of British India only. The justice or otherwise of taxing the subjects of the Indian States, whether those which have been partially compensated at least by the specific Treaties above mentioned, or those receiving no such compensation, is an open question, which British Indian financiers have so far answered in their own favour, but which the reawakening consciousness of their own rights among the States makes the latter reopen the problem with tenacity. As between the British Provinces and the Government of India, there can, of course, be no question about the right of the central Government using this tax for its own purposes. It is in the fitness of things that the Central Government should take up this revenue as it takes other indirect taxes,—like the Customs revenue—while the present system endures. But as between the Government of India and the Indian States, the question is by no means so simple, I shall touch upon the States' point of view in this behalf in the Lecture dealing with the Finances of the Indian States. Reference has been made to it here, because under existing circumstances, the Salt Tax seems to be a permanent and integral element of taxation in India, which the Government of India is unlikely to be able to dispense with in the near future. Being such a considerable figure, and

being habitually used as a reserve in times of emergency, the tax is prized for reasons other than those of the year's balancing. But the reasons make it equally valuable to those units which feel themselves unjustly deprived of this handsome source of revenue. In a proper federal financing it is probable the Salt Tax may be left to the Government of India, even as other excises might be similarly distributed. But if that consummation is ever to be reached, the needs of the States and the Provinces will have to be satisfied better than they have so far been.

Opium is another head of still considerable importance, inasmuch as in the latest Budget of the Government of India it is estimated to yield about 3½ crores, or nearly 3% of the Imperial net revenues. The item, however, is of diminishing importance, since the treaty obligations of the Indian Government have compelled that body to reduce progressively the cultivation of poppy in India and the export of the drug to the foreign countries, once the greatest consumers of the drug. It is now no longer commanding the importance its mention once used to command, since all parties are agreed to the sacrifice. From the standpoint of federal financing, however, this item has still considerable significance. The Indian States most concerned as growers of poppy, or manufacturers of opium of the very best quality, have been taxed since the commencement of the British Dominion in India, by means of the so-called pass duty, which was really a Transit Duty. The obligations incurred by the Indian Government have been incurred without reference to the Indian States; and those of the latter who have accumulated large stocks of Opium, and have consequently locked up therein considerable amount of capital, are naturally

uneasy at the recent developments, even though on the side of ethics they may have nothing to complain. Their case in this respect will be outlined in its proper place. Here it is enough to add that the revenue, while it continues, demands a treatment in distribution in a system of federalised finance which, to be acceptable, must involve no undue hardship upon any member of the federation.

Another point, likewise, which makes the revenue from Opium interesting from the standpoint of federal financing, is in connection with the Excise Opium. Unlike other countries of a federal character, India allows Excise revenue to the provinces. Wherever there is restrictive excise duty of high incidence, there is danger of interprovincial smuggling, especially if the rates of duty on given articles vary considerably as between provinces. Excise Opium, or that portion of the drug consumed in India itself, is a source of revenue to the provinces in British India, yielding some 2 crores of rupees; and each province has its own separate rates of taxation for this drug. The Taxation Enquiry Committee has laid it down :—

> "In the case of restrictive Excises, the considerations applicable to excises for revenue apply where special limitations on transport are not imposed, and it has been suggested that it would be desirable for the purpose of getting rid of unnecessary competition, to transfer to the Government of India the excise duty on locally made foreign liquors. . . . . In the case of opium it would seem desirable that the whole of the revenue should be transferred to the Imperial Government. The manufacture of this drug is already under the control of that Government, and recommendations have been made for the introduction of Imperial control over interprovincial smuggling, and of a uniform high rate of duty and the abolition of the system of sale of shops by auction. The international obligations that have been undertaken are likely to involve sooner or

later Imperial intervention in matters of consumption. It would be appropriate in these circumstances that revenues should follow control, though the direct management of the arrangements for retail vend might continue in the hands of local governments."

(Para. 523 of the Report, Taxation Enquiry Committee.)

Further considerations must be postponed until we come to consider Provincial Revenues under the existing arrangements.

Of the remaining items under the " Principal Heads of Revenue,"—to adopt the terminology of the Indian Budget,—Land Revenue, Excise, Stamps, Forests and Registration, are mostly provincial heads. Their contribution in the Imperial Budget is due to those areas, which, like Delhi, Coorg or Ajmere or the Frontier Province, are still directly under the Central Government. We shall discuss these in their appropriate place, while considering the provincial revenues. The only remaining item in the principal heads is Tributes from Indian States. This is a diminishing source, and has little correlation now with its original purpose and importance. The item, is, however, productive of a good deal of controversy as between the Indian States and the Government of India, which now take the entire income from this source. Except for a continuity in lifeless tradition, there seems to be little justification for maintaining this item in the Budget of the Government of India, especially if the ideal of a federal organisation is not to be denied. We shall consider it a little more fully when discussing the finances of the Indian States.

The Irrigation Receipts are provincialised, and the item in the revenue schedule of the Indian Government is due to the same reasons as obtain in regard to other items of provinvialised revenue.

The receipts from the Post Office and the Railways are considered in the nature of profits from commercial departments. There is, however, an element of service in these activities of the state, conducted to the community at the lowest possible charges, which must counteract such commercial tendency as might be in operation. On the other hand, there is an element of taxation in the charges of these "commercial" departments, which also militate against the idea of regarding the income from those sources as profits from commercial undertakings.* Inasmuch as these services are nation-wide, the revenue from them may fitly be considered as the proper dues of the federation; though, in regard to the purely local telephone, or a city tramway, or a district railway, the claims of the local governing body like a municipality would be impossible to question. The counterpart of railways, again in the shape of canalised rivers, or road transport in general, may have similar claims from the provincial governments and the States, which it would be equally hard to question. Most of the leading Indian States have, in fact, built their own Railways, and at the same time made many substantial concessions to the Imperial trunk lines passing through their territory. Specific treaties regulate the relasions in this behalf. They are, however, by no means satisfied with the treatment meted out to them in regard to the through traffic on the railways passing through their territories, or even on railways built by them as auxiliary to the main lines. This is another sore point in the relations between the Indian States and the Government of India, which I shall discuss a little more in detail when I come to Indian States Finances in a later Lecture.

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* For the nature of the Indian revenues from these commercial services. see the present prssent write's *Sixty years of Indian Finance*, Part III, 2nd Edition.

Income of the Government of India under the head "Interest" is derived from loans made to the Indian States, the Provincial Governments, or local bodies ; and causes no problem in Federal Finance for the Empire. The Receipts from Civil Departments are in the nature of fees for the services incidentally performed by these departments, and the bulk of them are provincialised. The same may be said as regards the revenue from Civil Works. We shall encounter them once again while discussing the provincial revenues.

Currency and Mint must be a Federal Function, though the revenue derived from this source by the Government of India is both considerable and peculiar enough to demand special treatment. The bulk of this income is due to interest on the securities held in the Gold Standard Reserve, and against the paper money of the Government of India issued as a public monopoly. This is a saving in interest, which is not the same thing as an ordinary revenue of the Government. Inasmuch as some of the Indian States have mints of their own, and even their own independent paper currency issues, the problem is complicated in regard to those who, having once had their independent monetary systems,have now sacrificed the same in the interests of achieving a proper federal unity. They now feel however that their subjects and themselves are taxed indirectly and unjustly by the Government of India, in proportion to the fiduciary currency of the Government of India which they and their subjects use. We shall consider this subject in greater detail, while discussing the monetary and banking system on a federal basis in a later Lecture.

Military Receipts are claimed entirely by the Government of India, as military expenditure of all kinds is shouldered by that body. These are

all departments more important for expenditure than for revenue ; and the review in the next Lecture of the Public Expenditure of British India will help to explain much that in this Lecture has necessarily to be passed over cursorily. In regard to the Military Department, however, the observation may be added that the function ofDefence is in all federations made over to the central federal Government, for the obvious economy of concentration of authority and organisation. Local Militia is allowed in some federations to the constituent states, and Police force in all instances to the Local Governments. In India the major Indian States have a sort of an army each of their own ; but the defensive or fighting value of these forces is not very great, though its expense to the states is considerable. The provincial armies have long since been abolished, though in the early days each Presidency had its own Army. The Police force is, of course, entirely provincialised.

III.—The Provincial Revenues in British India.

Coming next to a review of the Provincial Revenues of British India, the first fact we find in connection therewith is that the Provinces *inter se* are by no means equal. We have already seen the several sources of revenue in the provinces in tabular form while considering the revenues of the Central Government. Without repeating that Table, let us note here, inthe subjoined Table, the revenue resources of the Provinces *inter se* :—

Name of Province.	1921–22.°	1922–23.°	1923–24.°	1924–25.°	1925–26.°	1926–27.°	1927–28.°	1928–29.°
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
Madras	11,74,83	12,57,75	12,99,38	12,79,03	14,71,35	15,18,50	16,76,23	..
Bombay	13,10,72	14,17,19	14,52,82	14,99,17	15,24,18	14,58,07	15,53,23	..
Bengal	8,22,44	9,84,95	10,13,16	10,34,23	10,10,17	10,50,35	10,71,89	..
United Provinces..	10,01,55	10,03,04	10,31,14	9,99,53	10,86,67	11,38,71	12,83,22	..
Punjab	7,09,68	8,27,90	9,15,82	9,77,71	11,51,99	10,85,71	11,02,49	..
Burma	9,17,71	8,87,11	9,36,46	10,31,10	10,68,83	10,54,25	10,33,74	..
Bihar & Orissa ..	4,42,62	4,94,11	5,28,29	5,36,53	5,78,93	5,73,47	5,65,36	..
Central Provinces .	4,71,87	5,15,33	5,17,11	5,25,34	5,35,14	5,07,02	5,46,91	..
Assam	1,81,53	1,84,43	2,10,87	2,30,48	2,50,05	2,43,49	2,66,48	..
Total ..	70,43,03	75,73,85	78,85,00	81,28,18	87,51,20	86,43,16	90,99,55	..

N.B.—The Figures for Coorg given for the last three years in the Statistical Abstract are omitted, and those for the Shan States Federation are combined with Burma.

(*N.B.*—The figures are taken from the Statistical Abstract and relate to the Ordinary Revenue, in thousands of rupees.)

Growth in the principal items of revenues, imperial and provincial, is shown in the next Table:—

Progress of Reuenues, Distributed Between the Provincial Governments, in British India.

(*N.B.*—The figures are in thousands of rupees).

Items of Revenue.	1921-22. Imperial.	1921-22. Provincial.	1922-23. Imperial.	1922-23. Provincial.
	Rs.	Rs.	Rs.	Rs.
Customs	34,10,98	..	41,34,65	..
Taxes on Income ..	18,74,13	3,43,41	17,99,41	14,53,00
Salt	6,34,37	..	6,82,46	..
Opium	3,07,24	..*	3,78,92	..
Land Revenue ..	33,18	34,38,98	42,93	34,92,23
Excise	53,80	16,64,81	51,68	13,03,53
Stamps	24,61	10,63,45	25,10	11,70,06
Forests	19,68	5,63,60	25,28	5,26,85
Registration	1,70	1,11,84	1,49	1,18,95
Tributes	87,17	..	87,50	..
Scheduled Taxes ..	..	..	..	27,77
Total ..	64,76,91	71,86,12	72,29,44	71,53,94
Railways	15,20,82	2,17	26,82,98	98
Irrigation	5,94	5,71,81	10,90	6,58,46
Post Office	56,52	..	1,22,29	..
Interest	1,11,00	1,07,89	1,15,70	1,40,31
Civil Department ..	77,29	2,73,38	44,3[illegible]	3,27,94
Currency	4,37,42	..	3,62,03	..
Civil Works	11,32	62,42	14,38	62,85
Miscellaneous ..	7,18,56	1,37,95	62,46	1,52,36
Military	8,06,94	..	5,73,74	..
Contributions and Adjustment	12,98,72	—12,98,72	9,22,93	—9,22,93
Extraordinary ..	..	..	..	..
Total Revenue ..	1,15,21,50	70,43,03	1,21,41,29	75,73, 9

(*N.B.*—The figures are in thousands of rupees).

Items of Revenue.	1923-24.		1924-25.	
	Imperial.	Provincial.	Imperial.	Provincial.
	Rs.	Rs.	Rs.	Rs.
Customs	39,69,64	..	45,75,31	..
Taxes on Income ..	18,23,55	25,56	16,01,48	19,75
Salt	10,01,50	..	7,39,04	..
Opium	4,24,81	..	3,79,76	..
Land Revenue ..	43,05	34,46,52	37,80	35,45,77
Excise	48,25	18,92,27	41,99	19,09,69
Stamps	27,72	12,43,53	26,89	13,00,01
Forests	21,20	5,40,98	16,11	5,51,34
Registration	1,55	1,21,26	1,64	1,25,82
Tributes	86,77	..	82,44	..
Scheduled Taxes ..	..	33,13	..	30,55
Total ..	74,48,08	73,03,08	75,02,54	74,82,95
Railways	32,69,42	3,81	37,22,94	3,03
Irrigation	10,5[illegible]	7,06,67	10,92	6,99,73
Post Office	96,12	..	1,11,25	..
Interest	3,16,59	1,58,67	3,41,00	1,94,61
Civil Departments ..	68,51	3,44,07	73,97	3,51,36
Currency	3,12,74	..	3,99,33	..
Civil Works	37,05	65,60	13,21	72,30
Miscellaneous ..	94,78	1,86,79	45,89	1,98,55
Military	4,81,56	..	4,03,11	..
Contributions and Adjustment	8,83,55	—8,83,55	8,74,46	—8,74,46
Extraordinary° ..	2,59,65	..	2,54,52	..
Total Revenue ..	1,32,78,64	78,85,14	1,37,53,18	81,21,18

(*N.B.*—The figures are in thousands of rupees).

Items of Revenue.	1925-26.		1926-27.	
	Imperial.	Provincial.	Imperial.	Provincial.
	Rs.	Rs.	Rs.	Rs.
Customs	47,77,95	..	47,38,10	..
Taxes on Income ..	15,85,93	26,10	15,64,96	33,32
Salt	6,32,96	..	6,69,81	..
Opium	4,14,99	..	4,33,13	..
Land Revenue ..	38,52	35,16,73	41,00	34,47,31
Excise	42,20	19,47,66	41,13	19,41,55
Stamps	27,14	13,38,45	26,68	12,92,93
Forests	18,74	5,80,44	23,57	5,95,26
Registration	1,68	1,43,70	1,57	1,44,12
Tributes	84,29	..	83,52	..
Scheduled Taxes° ..	..	35,11	..	36,45
Total ..	76,24,44	75,88,26	76,23,52	74,90,96
Railways	34,40,12	3,27	34,07,08	2,24
Irrigation	12,03	7,48,15	10,25	6,69,30
Post Office	86,35	..	70,64	..
Interest	4,21,95	2,34,07	4,05,59	2,35,64
Civil Department° ..	89,98	3,58,82	86,05	3,65,64
Currency	4,63,89	..	4,15,51	..
Civil Works	12,85	68,18	15,79	69,21
Miscellaneous ..	54,17	2,03,70	60,01	1,91,40
Military	4,39,51	..	4,94,68	..
Contributions and Adjustment	6,08,40	—6,08,40	5,17,75	—5,13,22
Extraordinary° ..	63,57	1,55,12	60,10	1,31,47
Total Revenue ..	1,33,17,30	87,51,20	1,31,69,99	86,43,15

As between the several heads of revenue, especially from the standpoint of their respective benefit to the Central or the Provincial government, it is noteworthy that in the Imperial Budget, the Customs revenue has improved from 34.40 to 47.38 crores, while Income Tax receipts show a decline of nearly 2 crores. The provincial share of this item, however, has dropped from 3.43 crores to 33.33 lakhs. Salt and opium and the other smaller items in the central Budget are pretty nearly steady, the aggregate of the principal heads of revenue showing an improvement in that Budget of 11.53 crores in 6 years, or about 18 p.c. On the provincial side, the biggest single item, Land Revenue, shows a slight increase of 1.36 crores or about 4% in that head only; while Excise grows from 16.64 to 19.39 crores or 16½ %; and stamps from 10.63 to 12.92 or 23%. Forests and Registration show little increase, the aggregate showing a growth in the principal heads of revenue in the provinces of about 5.7%. Irrigation is the most productive department under the provincial governments, which shows a considerable rise, while Departmental receipts and Interest come very near thereafter. The Imperial Government's revenue under the commercial services shows a variation, a part of which is explained by changes in the system of keeping accounts, and the rest of the increase is a material gain. The fall in the Military receipts, and the abolition of the Provincial Contributions is made good in part by the improvement in the principal heads noted above, and in part by the gain from the commercial services, interest head, and currency receipts.

We have reviewed the income of the provinces under the several heads in the aggregate; but it must be noted that the fortunes of all the provinces have not varied in the same direction, or to the same extent. Of the total gain of nearly 21 crores in

8 years, Madras shows 5 crores, Bombay Bengal $2\frac{1}{2}$, U. P. $2\frac{3}{4}$, Punjab $4\frac{1}{4}$, Burma $1\frac{1}{4}$, Bihar and Orissa $1\frac{1}{4}$, and Central Provinces $\frac{1}{2}$ and Assam $\frac{3}{4}$%. The real improvement in the provincial resources is, of course, less by the amount of the contribution remitted in each case. The individual heads show a yet greater variation.

It will be seen from these tables that between themselves the Provinces are not of the same, or even comparable economic position. As must be seen from another Table in an earlier Lecture, the *per capita* taxation of the wealth in each province is surprisingly different. There is, at the moment, considerable volume of public opinion in favour of regrouping the existing provinces. These are *ad hoc* creations in response exclusively to the requirements of administrative convenience, and have no inherent sense of integrity among themselves. Their reconstitution on bases more harmonious intrinsically and ethnically must promote, no doubt, their local unity and integrity. But, if the idea ever matures, its sponsors will have to devote far more attention than has been customary so far to points seemingly of detail like the finances of each division of a dismembered province. It is, of course, not inconceivable that each such reconstructed unit might be able to support itself financially, on a modest scale of administrative efficiency and progressiveness, and with a basis of expenditure far more moderate than to-day. But, necessarily, that scale cannot be common to the nation as a whole, except possibly in the barest minimum. There is thus a danger of a falling off in efficiency in the reconstituted and smaller provinces, which the makers of the new constitution for India cannot too rigidly guard against.

Apart from the suggestion of reconstructing provinces, there is a remarkable inequality as bet-

ween even the existing provinces, though the sources of revenue assigned to them are pretty nearly the same in all the Governors' Provinces and in Burma. We shall consider these sources *seriatim* in a minute; but it is necessary to point out in passing at this juncture that the demand from the provinces of a cash contribution for the benefit of the Central Government operated, while it lasted, doubly unjustly as between the several provinces. Not only did this demand overlook the needs of each province itself for nation-building purposes; it added in several cases a burden, over and above the imposition made upon them indirectly in the shape of an exclusive centralisation of some of the most productive sources of revenue from these provinces. The growth, therefore, over the period reviewed in the foregoing tables, in the revenue resources of the several provinces, is unavoidably different to a marked degree; and hence the emergence of an unhealthy, undesirable feeling of provincial jealousies, which imperceptibly cuts at the very root of our national solidarity. In India, we have plenty of elements of division, as it is. To the ardent nationalist, however, the hope is ever present that these existing divisions are but a passing phase. But if to the existing factors of division are added others of a more permanent nature,—such as a cleavage in the economic interests, intensified by the different treatment in the financial distribution,—the hope of national solidarity must vanish altogether.

IV. Individual Items of Provincial Revenues.

Taking, next, the individual items of Provincial Revenues, the most considerable in all the provinces is the Land Revenue. This Revenue is derived in a variety of ways in the several provinces, and is governed by principles settled nearly a hundred years ago, if not more, in the case of the older

provinces. Despite the variation in detail, however, two, or three, main systems may be mentioned, as comprising, within them, the totality of the several ways in which Land Revenue is derived in British India. In the older Provinces of Bengal, Bihar, Orissa, Assam, parts of Madras and of the United Provinces, the revenue is settled permanently with some big landowners. When the settlement was originally concluded with them, these zamindars were called upon to pay a heavy percentage of the then total yield of the land made over to them in the form of the revenue demand; but in course of time, with the growth of a settled government and the consequent all-round development of the country, they now obtain a much larger proportion of the total yield as net income for themselves. Since the Land Revenue demand of Government is fixed in perpetuity with the Zamindars as the composite demand, to the exclusion of all other taxes on this income from land, the net burden falling on this class has come to be very small and inequitable, when viewed in proportion with the corresponding burdens on the other sections of the community. This is, however, a point in the theory of Public Finance, and particularly in the principles of taxation, which need not detain us here. The point, however, is worth mentioning, even from the standpoint of Federal Finance, not only because of the inevitable consequent injustice as between the several provinces, some of which have this form of Revenue Settlement,—and therefore escape the central burdens by way of income taxes,—while the others have a radically different settlement; but also because of its reaction on other forms of revenue receipts by the provincial governments concerned. We shall have occasion to refer to this point once again ater on. Fo r the moment let us pass on to notice another very considerable form of Revenue Settle-

ment, which is commonly known as the Ryotwari System of Land Revenue Settlement. This differs in almost every important respect from the first, or the so-called Zamindari system of Land Revenue Settlement. For, while the Ryotwari system brings the Government face to face with each individual cultivator of land, and consists in a cash demand of revenue fixed for a certain number of years, but *not* in perpetuity, the Zamindary form of settlement makes the Government deal with large intermediaries, leaving them to bear all the responsibilities of cultivation of land and the collection of revenue, under the general principles laid down by law. The relative proportions of Zamindary and Ryotwari areas and revenue in all India, as well as in the several provinces, are given in the table appended, which also explains its consequent injustice.

Table showing the area, Land Revenue, and its incidence in the several Provinces.

Name of Province.	Nature of Settlement.			Amount of Land Revenue in Columns.		
	Zamindary. Permanent.	Zamindary. Temporary.	Ryotwary.			
	(Area in Million acres.)			(In Lakhs of Rupees.)		
				II.	III.	IV.
Madras * 1 (1923-24)	29.628	....	62.091			
Bengal (1922-23)	37.864	11.310	....	86.105	..	642.33
Bihar & Orissa (1921-22).. ..	41.889	11.222	....	226.75	64.82	..
Assam (1925-26)	3.931	1.698	27.538	107.15	49.44	..
United Provinces (1921-22) ..	7.431	60.391	....	3.76	11.39	93.26
Punjab (1925-26)	....	55.322	....	57.77	641.81	..
Bombay (1925-26)	....	4.042	74.594	..	521.03	..
Burma (1925-26)	....	....	155.653	..	13.27	463.19
Central Provinces (1925-26) ..	....	40.411	11.209	..	..	573.08
				..	110.44	111.22
Total of the principal Provinces	120.820	185.390	331.087	482.49	1,412.19	1,882.10

While the average incidence of the Land Revenue in the Ryotwari areas comes to over Rs. 2. per head, that in the permanently settled Zamindary areas is less than ¾ of a rupee per head of population in those areas. If the incidence was made uniformly Rs. 2 the land Revenue would exceed Rs. 56 crores as against the present 36 crores. Any how, taking all the Zamindary areas collectively,—whether settled temporarily or permanently,—the margin of revenue, which in the Ryotwari areas goes to the Government, but which in these Zamindary areas is left to the owners, is very considerable. In the Zamindary areas temporarily settled, there is in many provinces an element of direct settlement of the State Revenue demand with the village communities, so common and immemorial in Northern India. Apart, however, from these collective settlements, there is a very considerable margin of revenue left to the proprietors of large estates in parts of northern India, which indicate a legitimate margin of further taxation, if the needs of the State are impossible to satisfy in any other way. As already promised, this is not the place for me to discuss the economic nature and financial bearing of the entire Land Revenue in this country, nor of the Government Policy in that regard. I am, likewise, not going to touch upon such episodes in recent financial history, as that in connection with the Revised Settlement of the Land Revenue in the Bardoli Taluka of the Surat District in the Bombay Presidency, nor touch upon the significance of such episodes in general. But I must point out,—from the standpoint of a proper, scientific, federal finance in this country,—that the incidence as well as the yield of the Land Revenue in the country as a whole demands radical reconsideration. There are vast areas in the country,—usually with Ryotwari settlements, made directly with the poorest

peasantry in the world individually, and maintained and administered with the entire might of one of the most powerful governments of our days,—in which the incidence of that tax offends as much against the canons of public economy, as against those of social justice. Land Revenue, being in the nature of a direct tax, must conform to the basic requirements of such direct taxation in all its other forms, particularly in respect of graduation of the rate of the tax in proportion as the ability to bear that burden is obviously increasing, and including an exemption limit of what is called the margin of subsistence. While the Ryotwari settlements, temporarily made, do not admit of any exemption of such a margin, and are not susceptible to a proper graduation, the land revenue from the larger proprietory estates, whether permanently or temporarily settled, offends against the canons of economy in a radically opposite direction. The exemption of all incomes from agricultural estates large or small from all other direct taxation,—whether by means of Taxes on Income or Death Duties of all kinds,—adds insult to injury in a most considerable department of public finance of this country. A radical revision of the basic principles in regard to the entire subject of the revenue from land can, of course, only be attempted by the central national legislature of the country. But that need not mean that when the revised principles have been adopted and put into practice by the common consent of the nation, the revenue resulting must be taken up exclusively by the central exchequer. However, even if the revenue from land, with such supplements as may be devised, is left to the provinces,—as it must be,—some provinces will have to be enabled to meet such sacrifice as may be entailed by the reconsideration of the fundamental principles of charging that revenue: *e.g.* Madras or Bombay. These will have to forego

utterly a great deal of the present income from land, held by very small proprietors daily growing smaller, which is now called Land Revenue in those parts, the deficit so caused to be made up in some other way. In other provinces,—like Bengal, Bihar and Orissa, parts of the United and the Central Provinces, and the Punjab,—the present Land Revenue will have to be increased in the aggregate by an additional Income and Super Tax on the agricultural wealth of the larger proprietors of land, with suitable and adequate graduation. The combination of these two will, in all probability, mean no very material change in the revenue resources of the country as a whole; but it will mean very radical alterations in the relative financial position of the several provinces now existing, or their future reconstructed prototypes. This consummation in itself will create one of the most complex problems in the federal finance of India, that financial statesmanship will have to solve in the near future, but of which we have to-day no conception even. I have discussed some aspects of this problem in another work,* and so need not detain you here beyond observing, that if time permits, and your patience endures, I shall try and outline a scheme of redivision of resources in the concluding Lecture, which will, I trust, solve in a measure this very intricate problem.

For the moment, however, I must point out that, under the Constitutional Reforms of 1919-20, Land Revenue is handed over entirely to the Provincial Governments, though in them it is a "Reserved Subject;" on which, therefore, the responsibility of the Government to the representatives of the governed is not enforceable. The Revenue from Irrigation Works, collected along with the Land Revenue, though essentially a different form

* *The Sixty Years of Indian Finance.*

of public revenue, is also made over to the Provinces. * Notwithstanding the importance of these items of provincial revenues,—they make up from a third to one-half of the entire provincial income,—there are peculiarities attending them, which make them open to serious criticism from the standpoint of the provincial financier, and even from that of the student of the pure theory of the Federal Finance. In almost all provinces, the revenue is practically fixed and unalterable, in any given year, whether the province in question is one where the Zamindary system of permanent settlement prevails predominantly, or the Ryotwari. As the land revenue is an exclusive demand,—in the sense that the income or property which pays this tax is immune from any other direct tax,—there is no means of making the larger agricultural incomes bear their fair share of the growing burden of public expenditure. On the other hand, as the Land Revenue has been fixed, in the Ryotwari provinces particularly, under conditions which no longer obtain; and inasmuch as, at the time of fixing this demand, no attention is paid to the basic principle of civilised taxation, namely the correlation with the ability of the tax-payer to meet a particular tax-burden imposed upon him, the fixed cash demand for land revenue by the State operates as a severe injustice to the smaller men, who make up the bulk of the Indian agricultural community. The tax has to be paid, whether or not in any given year there is any income from the land charged with the tax ; whether or not, even more unjustly, there is anything left, after payment of the tax, for the maintenance of the tax-payer and his family. The provinces are in no position to reconsider this utterly indefensible—but very considerable—form of their revenue in its basic principles, until adequate and unobjectionable substitutes are devised to take its place. Under the conditions

that now obtain, in most of the agricultural ryotwari provinces at any rate, the Land Revenue offends against almost every accepted principle of enlightened taxation. Its revision, however, has been jealously guarded from the representatives of the people, not only because of the complexity of the interests at stake, but also because of the unwillingness of the present rulers of India to trust to the Indian Legislatures for exercise of such powers. They are naturally in tacit alliance with the propertied classes, as the main prop of the established government ; and hence the perpetuation of a system, which cannot be defended on any ground of sound finance, or just politics.

Apart from the injustice just mentioned, there is a further objection to the existing policy in respect of Land Revenue. The burdens as between the several classes of the community are made unbearably disproportionate. While the larger land-owners escape the just share of their burdens in proportion to their ability, the smaller cultivators are charged with a revenue demand, which sinks them cumulatively into the bottomless morass of debt, deficit, and misery. Besides, in the case of the smaller Ryots, land revenue is by no means the only burden of state expenditure that these unfortunates have to bear. They pay the bulk of the Salt and the Customs Revenue to the Government of India; and Excise Revenue, Stamps dues, Forests and Registration Receipts to the provincial governments, not to mention separately the Irrigation dues. The Indian Taxation Enquiry Committee have made an *ad hoc*, arbitrary, and, in my opinion, unscientific classification of the Indian people from the standpoint of the bearing of tax-burdens. I have endeavoured to question their findings and conclu-

sions on this subject in the 2nd Edition of the *Sixty Years of Indian Finance.** But even on their assumption, the tax-burdens on the least able of the Indian people are disproportionately heavy. The Committee have overlooked the correlation between income and ability; and so in their findings the burden does not appear to be as heavy as in reality it is. Unless and until the basis is revised by the National Assembly, not only of the Land Revenue systems, but also of the entire system of public finance and national economy in the country as a whole, there can be no hope of a satisfactory system of sound, smooth Federal organisation. Under any scheme of revision, however, the administration of the Land Revenue, or rather of direct taxation of real as well as personal wealth, must be left to the Provinces. Further considera-tion of this topic must be postponed.

The Excise Revenue.

Next in importance to the Land Revenue stands the revenue from Excise in the present scheme of federal finance in India. It makes over 22% of the aggregate provincial revenues, and in some provinces a still greater proportion. I must refer those amongst you who may be unfamiliar with the nature of this revenue to another work of mine already referred to. But, from the stand-point of Federal Finance, it is worth remarking that the Excise Revenue also demands radical revision before it can be accepted as an item in the scheme of satisfactory federal financing. In the first place, it is a peculiarity of the Indian system that this source of indirect taxation is left to the provinces; while a federal government takes the nearly equal amount from the taxes on income,—on administrative rather than financial grounds. In other fe-

* Cp. Op. Cit. pp. 364-374. Also the Taxation Committee Report, pp. 342 *et seq.*

derations, old as well as new, all kinds of indirect taxation is left to the central federal authority. The Indian Taxation Enquiry Committee have already opined that, at least restrictive excises should follow the authority which controls their administration, *i.e.* the Central Government.* Says that Committee :—

> "In the case of excises for revenue, it is generally difficult to trace consumption. Moreover, they should in many cases be regulated with reference to customs duties. It is therefore desirable that they should be imperial. . . . . In the case of restrictive excises, the considerations applicable to excises for revenue apply where special limitations on trasport are not imposed, and it has been suggested that it would be desirable, for getting rid of unnecessary competition, to transfer to the Government of India the excise duty on locally made 'foreign' liquors."

This is highly suggestive. I have already referred to the Committee's opinion in respect of the Opium Revenue from local consumption; and I may add that they would make a partial exception to their general principle of dividing the revenue resources of the country, in respect of their suggestion for a revenue from tobacco. All revenue from the customs or excise duty on cigars, cigarettes and pipe tobacco, made up in the European fashion, they would leave to the federal government of India ; " but the indirect excise on country tobacco, which it has been proposed should be taken through a monopoly of vend, could only be provincial " (para. 523). But the Committee fail to consider adequately, in my opinion, the financial effects of their suggestions. It is obvious that these suggestions, taken collectively in regard to the entire excise revenue, would very considerably deplete the provincial revenues. And this quite apart from that other, and by no means less import-

* Taxation Enquiry Committee's Report, cp. para. 508, 523. Also para. 227.

ant consideration, that, even as it is, the excise revenue is a depreciating asset. A very large section of public opinion in the country, growing in volume and influence every day, is strongly in favour of a complete Prohibition of any traffic in intoxicants of any kind. The Taxation Enquiry Committee have found it impossible to suppo r enthusiastically this ideal of prohibition, mainly on reasons of administrative expensiveness to give effect to such a policy; but also because they were not unmindful of the loss of revenue from this handsome source. It is possible, India may be unable to adopt a policy of absolute Prohibition, involving the complete sacrifice of all Excise Revenue, in the near future. But even if we admit that hypothesis, it is impossible to believe that financial or even administrative, considerations will by themselves prevent a reawakened people from enforcing the already accepted ideal of Excise Policy,—moderate and safe as it is. Hence there is little hope of the Excise Revenue showing any expansion of a financial nature, worth speaking of, in the near future. Provincial finance, therefore, cannot expect any help from this source either, in the reconstructed system of financial division in this country.

The Stamps, Registration, and Forests Revenue, aggregating in round terms 20 crores of rupees for all the provinces put together, have their own problems and complications, from our present standpoint of federal financing. The forest wealth of India has yet to be perceived in all its immense possibilities. But even when all those possibilities are realised, the present difficulties of a lack of capital will, I fancy, have to be faced no less than to-day. Provincial Governments to-day seem to consider the material development of their provinces to consist mainly, if not exclusively, in con-

structing irrigation works, of a productive as well as protective character. They may not be altogether unaware of the possibilities of forest industries development; but they will find the task of procuring adequate capital in financing forest industries, not to mention the necessary transport facilities, far more difficult even than finding money for Irrigation Works. The latter have come to be understood by the public. The danger in their case rather seems to lie in too hasty a consent to some of the projects that now attract the attention of certain provincial governments.

In the case of the income from taxation of transactions, by means of stamp duties and registration fees, the Taxation Enquiry Committee holds:—

> "Taxes on transactions in other countries ependd largely on the extent and importance of the separate States, and the extent to which they have adopted their own stamps, postal and other, or use a system of embossing stamps instead of that of stamp papers. In India, it is not only highly inconvenient to have varying rates of duty, but also, so long as uniform stamps are maintained for the whole country, it is not equitable to continue the system of division of sources in the case of the stamp duties. For both reasons it is very desirable that the stamp duties should be retransferred to the Imperial Government. Other taxes on transactions should continue to go to the provincial governments."*

You will notice that this recommendation is in direct contradiction to the arrangements made under the Meston report, and even under the general scheme of the Reforms of 1919-20. For my part, I confess I am not moved by the reasons that have been adduced by the Taxation Committee thus to put back the hands of the financial clock in this country. In fact, it seems to me, that the Committee appear to have constituted themselves the champions of the Central Government, at least if one were to judge from the resources this Com-

*Cp. cit. para 524

mittee would place at the disposal of that body, If all their recommendations were carried out, the provinces would be either turned into mere subsidy-holders of the Government of India, having no adequate resources of their own; or being in chronic want of funds for the due discharge of the most vital functions assigned by the constitution to them. I consider the need to maintain a strong and efficient central government to be beyond question or cavil, for the moment, in this country. But I would not accomplish that ideal at the expense of provincial autonomy implied in such recommendations as I have quoted above. Besides, I doubt if the public opinion of the country would, at this time of the day, consent to such a reversal of the trend of development hitherto followed, which would once again make the provinces merely the pensioners of the central Government. The difficulty will, of course, be unspeakably greater in regard to the States. But I am not considering their case for the moment, and so it is not necessary to add the complication caused by their existence. Even, therefore, from considerations applying entirely and exclusively to British India, the scheme of federal financing, envisaged or implied in the recommendations of the Indian Taxation Enquiry Committee, is unthinkable as commending itself to any considerable proportion of the representatives of the people, in the central or the provincial legislatures, not to mention the official element as it now stands. Fortunately, the Taxation Committee's Report has not yet materialised in any considerable measure in a definite policy; and so, perhaps, it is unnecessary to devote further consideration to their reactionary proposals for financial reconstruction.

There is no need to mention more particularly the other sources of provincial revenues. They

consist largely of departmental receipts, mainly in the nature of Fees for services; and, as such, they do not admit of any very great expansion. Besides, they create no special complication from the standpoint of federal financing. We may, therefore, pass over these, as also the item of provincial revenue in the shape of Interest, which is derived from loans made to the local governing bodies within each province.

In the next Lecture I shall try and present to you a similar analysis of the public expenditure of the country.

LECTURE IV.

Review of the Public Expenditure In British India.

The Public Expenditure of British India, since the Constitutional Reforms of 1919-20, shows the following progress*:—

Year.	Imperial.	Provincial.	Total.
	Rs.	Rs.	Rs.
1921-22(Accounts)	1,42,86,52,017	79,16,25,536	2,22,02,77,573
1922-23 ,,	1,36,45,05,548	77,23,38,522	2,13,66,44,070
1923-24 ,,	1,30,39,64,769	76,09,28,660	2,06,48,93,429
1924-25 ,,	1,31,84,92,421	78,40,69,723	2,10,25,62,144
1925-26 ,,	1,29,86,12,305	85,89,52,792	2,15,75,65,097
1926-27 ,,	1,31,69,99,799	90,17,32,793	2,21,82,69;793
1927-28 (Revised Estimates) ..	1,27,73,98,000	92,30,25,000	2,20,04,23,000
1928-29 (Budget Estimates) ..	1,29,59,69,000	96,47,09,093	2,26,06,78,093

* The figures are taken, as to the first six years, from the *decennial statistical Abstract* of the Government of India (1917—18 to 1926—27) and for the last 2 years from the Budgets of the Imperial and the several Provincial Governments.

These figures do not indicate any substantial retrenchment in expenditure that was so much talked of soon after the Reforms ; nor is there any real saving in the public expenditure of the country as a whole. The fall in the total expenditure of the Imperial Government of India is explained, in a very considerable proportion at least, by the artificial increase in the exchange value of the Rupee, and the consequently smaller requirement in term of rupees for meeting the so-called " Home Charges" of the Government of India. The expenditure of the Government of India in England is payable in sterling ; but the wherewithal for those payments is obtained by the Government of India in terms of rupees. There is many an intricate problem of politics and economics connected with this branch of the public expenditure in India, which this is not the place to discuss. There is one aspect, however, of this expenditure, in connection with the manipulation of the standard unit of money in the country, which is entailed upon the Government of India inevitably by the existence of these "Home Charges;" and which materially affects, not only federal financing in the narrower sense of the term, but the entire system of our national economy. Currency and its administration are, in all federal constitutions, entrusted to the central government, as a rule ; but the implicit condition of such entrustment is that the administration of this vital function will be conducted by the central federal government in the collective interests of the nation as a whole exclusively. Where, however, there is reasonable ground for apprehending, from actual experience in the past, that the authority in charge of the management of the nation's monetary systems with all its ancillaries is likely to be influenced by considerations benefiting only a part of the nation, —and not the whole, nor even a major portion of the nation's economic interests,—the manipulation

of the currency system, and, above all, of the standard of value, by such an authority is apt to be viewed with a suspicion by no means conducive to the health of the body politic. The Government of India has had many such experiences, and been invariably exposed to the suspicion of ulterior motives, which have brought about at least one undesirable consequence: Public opinion seems to feel there is no finality in the monetary policy of the Government of India ; nor, so long as the full, working, self-adjusting Gold Standard and Gold Currency are not introduced in this country, will its Government escape the taint of a suspicion clinging to it from the memory of its past misdeeds in this department.

The British Government in India is, moreover, not alone concerned. Most of the Indian States have surrendered their own separate mints and currency systems to be managed by the Imperial Government, in accordance with Treaties, the real spirit of which can hardly be said to be maintained in the currency revolutions that have been effected in the land by government fiat or legislative enactment, since 1893, when the Indian mints were first closed to the free coinage of the ages-old silver rupee. I have referred already, in passing, to the unfairness of the receipts from the two Currency Reserves of the Government of India going entirely to the British Government, when, as a matter of fact, those reserves have been built up by the Indian people as a whole consenting to use the artificially valued rupee of the Indian Government, and the paper money in terms of these rupees, whether in British India or in Indian States. I shall have occasion to refer to this matter once again, when I discuss the financial position of the Indian States, and their expectations under a federal system. For the moment, it is necessary to add that even in British

India itself, the monetary and currency policy of the Government of India, including its reaction on the credit system of the country and its capital resources, has hardly ever commanded the universal approval even of the British Indian public, ever since the Government of India found their finances disorganised by the vagaries of the rupee, and decided to take steps to arrest the variations in the exchange value of the rupee to the prejudice of the Indian Government or its non-Indian public servants. These steps have now a history of more than thirty-five years. But without going back all these years; and confining ourselves to the last considerable tinkering with the monetary system of India, we may note that though the action of the Government of India tended, apparently, to reduce the burden of the "Home Charges" on the Indian Exchequer, the Indian public, both commercial and intellectual, was almost to a man opposed to the changes advocated and carried through by the Government. The reason is not difficult to seek. The mercantile classes may have been swayed by considerations of class gain from an undervalued rupee; but the professional and considered opinion of Indian economists in general viewed with unconcealed apprehension and misgiving the opportunity for mischief inherent in a policy of tinkering with the exchange rate of the rupee, without definitising the standard of value, and making the entire currency system correspond to that definition. The currency charges undertaken by the Government of India in 1927 have not yet been all accomplished, including their latest failure to carry through the Reserve Bank scheme; and this by itself is sufficient to make us believe that the currency system of the country, and even its basis, have by no means yet reached any degree of finality.

This is not a needless digression. The undeniable effect of the very existence of these "Home

Charges" makes for a compulsory pinching in the provinces as well as the Government of India, in regard to the more material departments of the country's economic development. I have discussed the nature and bearing of this portion of the Public Expenditure of this country in another work, and shall, therefore, not take more of your time in repeating myself on that subject. But I must point out the connection between this expenditure, and the exchange value of the rupee a little more fully and in detail. The following table tells its own tale:—

Year. *	Amount of the Home Charges in Sterling.	Amount of the Home Charges in Rupees.	Rate of Exchange realised.	Rate of Exchange Budgeted.	Saving or loss in crores
	£	Rs.			
1921-22..	31,640,354	48,09,19,358	16*d*	18*d*	—5.75
1922-23..	31,744,737	48,47,44,229	16*d*	16*d*	+1.50
1923-24..	33,156,980	49,39,92,742	16½*d*	16*d*	+1.28
1924-25..	31,993,317	43,62,97,111	17½	16¾	+2.15
1925-26..	29,970,299	39,55,30,514	18 3/32	18	+0.23

The figures represent gross expenditure in England charged to revenue, *i.e.* it does not make allowance for the sterling receipts in England. The figures, moreover, are combined figures for the central and the provincial governments collectively, the provincial items being about 1½ million sterling in the aggregate. The rupee figures are taken from the accounts of the Government of India, the sterling figures from the *Statistical Abstract* for 1917-18 to 1926-27.

* The statutory rate was 2*s.*; but the Budget always assumed a hypothetical rate which made a saving if it rose, and caused a loss if it fell.

The Table is only for six years, the remainder being omitted, as the rate of exchange during the latter years has been kept steady at about 18*d*. per rupee, by administrative arrangements or statutory authority; and the consequent variations in the budgeted and realised rate negligible. But even in these six years, when the variations in the rate of exchange were considerable and significant, the influence of this factor on the general public economy of the country, as well as on the federal financing in the narrower sense, is undeniable. The total volume of the aggregate "Home Charges" of the Imperial and the Provincial Governments fluctuates somewhere about the post-war norm of £30 million per annum. The rupee cost of meeting these charges, at this standard figure, is, at 2/–per rupee, Rs. 30 crores; at £20*d*. per rupee 36 crores; at 18*d*. per rupee 40 crores; at 16*d*. per rupee 45 crores; at 15*d*. per rupee 48 crores. The difference of a penny in the exchange value of the rupee makes a difference of from 1½ to 3 crores. By fixing the exchange value of the rupee at 18*d*, they have made a saving to Government of 5 crores, at least, without reducing the total volume of the Home Charges, which alone can bring true relief in the national economy of India. The provincial Governments are concerned to a very small extent,—perhaps not more than 5% at most of the aggregate "Home Charges payable by the Government of India. But that does not make them the less interested in the savings, or losses, as the case may be, under the heading "Exchange." On the other hand, the export trade of the country is some 300 million sterling in round terms. At 24*d*. per rupee, the Indian producer would receive, for the same value of his 300 crores; at 20*d*. he would receive 360 crores; at 18*d*. he would receive 400 crores; at 16*d*. the rupee value of the exports would be 450 crores. The comparison is inevitable, as also the inferential reflection on the policy

hitherto purused by the Government of India in this connection. True, they have effected a saving, by steadily raising the exchange value of the standard of money in this country, of some 5 to 6 crores per annum in the aggregate in their own Budget. But whether that saving is not more than set off by the loss to the Indian producer of some 50 to 75 crores is a question that cannot be utterly ignored in considering the general effect of public finance on public economy.

The provinces are interested, though to a comparatively slight degree, in this matter from the purely financial side. Their interest, however, is very considerable,—as much as that of the Government of India,—from the standpoint of perfect federalism. This is an item of expenditure, which, as things stand to-day, is outside the authority of the Governments in India. The Secretary of State is responsible for the bulk of this expenditure ; and that responsibility is in no way owed to the public in India. Hence, the basic principle of true federal organisation is defeated, or evaded, by the existence of this item in the public expenditure of India. The only way to realise the ideal of perfect federation would be progressively to reduce this item, so as to abolish it altogether in a given number of years, at least in so far as such portion of this expenditure as must be made subject to due responsibility to the legislatures in India.

II.—Variations in the Aggregate of Public Expenditure.

The aggregate of public expenditure, in the period under review, does not show the variation that the revenue side shows. The total expenditure of the Imperial Government, for example, was the highest in 1921-22, being 142.66 crores. Steady efforts have been made,—to believe our Finance Ministers' annual statements,—to retrench

remorselessly ; so that the lowest point was reached in the Revised Estimates of 1927-28 when the Imperial Expenditure fell to below 127¾ crores. This is a difference at most of 15 crores ; and, as the Budget Estimates for the next year show, the difference is being rapidly undone. But even taking this difference at its maximum value, what does it amount to in reality ? As we have pointed out above, the saving in rupee remittances to cover the "Home Charges" amounts to some 6 crores in round figures, in the Imperial Budget alone. Granted that to be a saving, it is yet open to question how far it may be regarded as a true, economic, retrenchment, that scientific financing ought to aim at. And, on the other side of the shield, notice must likewise be taken of the cost to the country at large, and particularly to its productive interests, for affording this saving to its government at an artificially overvalued rupee. The remainder of the 15 crores,—9 crores, to wit,—may be admitted to be a retrenchment, subject to the general criticism, that the same number of rupees spent in 1928 represents 12½% more, simply because of the increase in the value of the rupee, and consequently in its purchasing power. If we apply this test, an expenditure of 130 crores represents, in 1928, what 146 crores represented in 1921-22, if not more, in terms of the purchasing power, to those who benefited from such expenditure. The Government of India have, more than once in the past, conceded to their public servants equivalent compensation, whenever they tampered with the standard of money in the country ; so that the changes in the exchange-value of the rupee need not affect adversely the " real wages " in a foreign standard of their non-Indian Public Servants. The Exchange Compensation Allowance, to give it its full name and style, was a grievous burden on Indian Finance from 1893 onwards ; and Indian critics of the financial policy of the Government of India have

criticised this item sufficiently for me not to repeat that criticism in this Lecture.* I mention this, however, in the present Lecture, to point out that, while the Government of India have not scrupled to impose burdens on the Indian public purse for the benefit of their public servants of non-Indian origin and domicile when their own exchange policy seemed to go against these servants, they have not included in the mechanism of public administration in the country any means to secure to the Government the full benefit of any alterations in the same department of Exchange, which could reasonably be expected to advantage those servants of the State.† This is one of several instances, that can be quoted from the financial history of the last three-quarters of a century, to show that the finances of India have not always been conducted by the present rulers of India with an eye exclusively to the best interests of India and her people !

Though there may seem to be a saving in the aggregate expenditure of the Central Indian Government, as shown above, there is, of course, not even such a saving, or retrenchment, on the side of the provincial expenditure. That expenditure shows, in the aggregate, a growth of 17 crores, not the whole of which means a *pro tanto* development of provincial administration. Nearly 10 crores of this seeming increase in expenditure under the provinces is nothing but a diversion of funds, from the contributions made by the provinces to the Imperial Budget to the direct spending by the provinces themselves. It would not be utterly irrelevant to point out in this connection the true nature of public expenditure in general. Properly conceived and planned, public expenditure should result in nothing more nor less than a redistribution of that portion of the wealth of the community,

* Cp. Sixty Years of Indian Finance, pp 51—58.

† *See* however Sixty Years of Indian Finance, p. 131.

which comes into the public purse, and is spent through public bodies. Even without any particular State accepting it as a set purpose of its activities to bring about a gradual and more equitable redistribution of the community's wealth by means of its public financing, the ordinary activities of the State, as manifested in its public expenditure, inevitably result in a promotion of the public welfare, if it is truly scientific in its design and operation. Even the seemingly wasteful item of military, or rather Defence, expenditure has this undeniable tendency, in a properly conceived system of public finance. In so far, therefore, as the item above-named, in the Indian public expenditure viewed collectively, means merely a change of authority actually doing the spending, no great point of principle affecting public economy is involved. From the standpoint of Federal Finance, however, and with particular reference to this country, the fact of this improvement in the provincial expenditure must be welcomed, if only because it represents the *pro tanto* increase in the attention paid, through the agency of public financing, to the material needs of the country. But perhaps this point will be better understood when we consider the several items of public expenditure, and the progress under each, in the Imperial as well as the Provincial Budgets. Here let us conclude this particular aspect of our enquiry by the subjoined table, showing the progress of expenditure in the aggregate in the several provinces since the Constitutional Reforms of 1919-20.* Among themselves, the Provinces show very nearly the same variety in expenditure, as we have seen them showing on the side of revenue. While Madras shows an increase of nearly 5 crores in 8 years, Punjab 4, Burma 2, Bihar and Orissa and the Central Provinces 1 each, Bombay, Bengal and the United Provinces show pretty nearly the same Budget on the expenditure side. Of these three,

while Bombay and Bengal might be said to have benefited the least by the remission of the Provincial Contributions, the United Provinces can hardly be said to be in the same category. Its provincial contribution was the next largest after Madras, and yet its increase in expenditure shows scarcely an expansion of 65 lakhs in 8 years. This

(*N.B.*—The figures are in thousands of rupees.)

* Province.	1921-22	1922-23	1923-24	1924-25
	Rs.	Rs.	Rs.	Rs.
Madras	12,73,60	12,60,77	12,63,07	13,08,50
Bombay	15,01,93	13,53,17	14,23,45	14,72,57
Bengal..	10,47,91	9,59,21	9,77,95	9,76,01
United Provinces ..	11,49,42	10,70,98	10,47,50	10,42,49
Punjab	8,81,11	8,85,44	8,04,01	7,94,73
Burma..	9,03,68	10,24,28	8,85,08	9,86,76
Bihar and Orissa ..	4,57,96	4,63,24	4,84,83	5,13,12
Central Provinces ..	4,95,40	4,89,57	4,94,42	4,88,25
Assam	2,05,23	2,05,46	1,90,01	2,00,29
Total ..	79,16,25	77,12,13	75,69,84	77,82,71

(*N.B.*—The figures are in thousands of rupees).*

Province.	1925-26	1926-27	1927-28	1928-29
	Rs.	Rs.	Rs.	Rs.
Madras	13,78,99	15,82,21	15,58,07	17,47,52
Bombay	16,15,52	16,51,68	15,99,03	16,49,83
Bengal..	10,30,63	10,70,95	11,03,95	11,19,62
United Provinces ..	11,72,43	12,84,79	11,70,74	12,04,30
Punjab ..	9,94,38	12,32,43	12,07,58	12,77,03
Burma..	10,79,52	11,91,98	12,09,72	11,78,46
Bihar and Orissa ..	5,54,92	6,05,01	5,94,21	5,87,96
Central Provinces ..	5,32,62	5,96,86	5,39,31	5,82,07
Assam	2,38,21	2,58,20	2,57,54	2,89,29
Total ..	85,26,23	95,74,11	92,30,25	96,36,29

indicates perhaps, the margin of financial initiative and autonomy in the provinces under the present constitution, which may have to be radically reconsidered when the Constitution itself is fundamentally recast.

To understand, however, the real scope of provincial economy and development, possible under the present arrangements, let us consider the individual items of expenditure in the Central and the Provincial Governments in British India. The subjoined table gives these items for the six years.

* The figures are taken from the *Statistical Abstract* 1917-18 to 1926-27, up to 1926-27, and thereafter from th individual Budgets of the Provinces.

for which the final accounts of the several governments are available.† It would be impossible to consider each of these items, with respect to its nature and bearing on the public economy of this country, within the limits of a single Lecture. May I refer those of you who may be interested in understanding the precise place and influence of each of these items to another work of mine, where the matter is considered from a different standpoint.† From the standpoint of Federal Finance, as applied to India, I think it would answer our purpose, if we took the various items in the classified groups in which they are shown in the public accounts of the country, as presented in the Table.

Let me note in passing, at this stage, two points of interest in detail to students of public finance as well as of federal organisation. The fact that the accounts of the governments in all the provinces as well as in the Central Government are presented on a uniform basis must redound very largely, not only to the convenience in administration, but also to simplicity in study. I am by no means convinced that the classification of the revenue and expenditure of the State in India is as scientific and exact as it well might be. In another work of mine, to which I made a reference just now, I have endeavoured to show why the existing classification is unsuitable, and what reasonable improvements can be made therein. Here it is enough to add that I propose to take up the detailed discussion of public expenditure, in the Central as well as the Provincial Government, under the following main groups:—(1) Direct demands on Revenue, including the cost of collection; (2) Developmental Expenditure consisting mainly of the Railways, Irrigation and the Post

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† Cp. *Sixty Years of Indian Finance*, Parts II and III.

Office Charges ‡ (3) Charges of Civil Administration in general; (4) Interest on Debt; (5) Non-effective Civil Charges; (6) and Military or Defence Expenditure. Of these, Defence, Debt, and Development of material resources are, almost exclusively, under the Imperial Government; while the remaining are shared in varying proportions by the Central and the Provincial Governments, as shown clearly in the Table foregoing.

The other point of interest to students of federal organisation is that, under the existing Constitution, there is a marked difference between what is styled "Voted" Expenditure, and "non-Voted" Expenditure both in the Imperial and the Provincial Governments. The following figures are illustrative of the difference :—

(*N.B.*—The figures are in Lakhs of Rupees).

Year.	Central Government Expenditure.				
	Total.	Voted.	Non-voted.	Ratio of	
1	*2	3	4	3 : 2	4 : 2
	Rs.	Rs.	Rs.	Rs.	Rs.
1921-22 ..	1,42,86	18,02	1,24,84	12%	88%
1922-23 ..	1,36,43	16,85	1,19,58	12.35	87.65
1923-24 ..	1,30,39	15,66	1,14,73	12%	88%
1924-25 ..	1,31,86	23,10	1,08,75	17%	83%
1925-26 ..	1,29,86	17,74	1,12,12	13.66	86.34

*The figures above are after deducting the working expenses of the Railways and Post Office, which would add about 80 crores to columns 2 and 3, and so affect the proportion of 3 : 2 and of 4 : 2. As, however, there is no responsible government in the federation, I have taken the net figures.

‡ For the nature of the Indian revenue from these commercial services, see the present writer's *Sixty Years of Indian Finance*, Part III, 2nd Edition.

(*N.B.*—The figures are in Lakhs of rupees).

Year.	Provincial Government Expenditure.				
	Total.	Voted.	Non-voted.	Ratio of 7 : 8	
1	7	8	9		
	Rs.	Rs.	Rs.		
1921-22 ..	79,16	58,94	20,22	74%	26%
1922-23 ..	77,23	54,13	23,10	70%	30%
1923-24 ..	76,09	61,14	14,95	80%	20%
1924-25 ..	78,27	61,72	16,56	78.8	21.2
1925-26 ..	85,77	67,82	17,95	79%	21%

In the aggregate of the Imperial and Provincial Expenditure combined, less than 40% comes before the Indian Legislatures to be voted ; and even of this small amount, not all the beneficiaries are under the so-called Transferred Departments, which are in the charge of responsible Ministers. In the Provincial Budgets the proportion is greater; but not all the voted expenditure even in the Provinces is in the charge of the Ministers responsible to the representatives of the people. In the case of the Government of India, the principle of Ministerial responsibility is conspicuous by its absence. For proper federal financing, I think it would be generally agreed there ought to be full responsibility enforced, as regards the spending authorities, towards the representatives of the people, in Legislative Councils assembled. And when that ideal is accomplished, it is more than

doubtful if the volume as well as the direction of the country's expenditure, no matter by what authority incurred and defrayed, will remain the same as it is to-day.

Review in Detail of the Public Expenditure in India.

Charges of Collection.

Taking the several groups of expenditure under the Central Government separately, we find that the cost of revenue collection, including refunds and drawbacks, is reduced in the six years for which the final accounts are tabulated on p.p. 185-6 from Rs. 527 lakhs, to 420 lakhs. Compared to the total net revenue of the Government of India, some 130 crores, this works out at a little under 3½%. Viewed historically, this is a considerable improvement or retrenchment, indicating either improved tax-collecting machinery, or internal economy in these departments. Compared to the cost of raising a much higher volume of inland revenue in England, the cost of tax-collection to the Government of India is considerable; and it is, perhaps, not too much to suggest that there is still room for further economies. India has, however, certain peculiaries of her own, which entail a relatively higher expenditure for tax-collection and administration. The country is very large; and the revenue has in many instances to be collected from a very large number of very small tax-payers, which naturally makes the tax-departments in India relatively more costly. From the stand-point of Federal Finance, however, it must be that the corresponding item under the Provincial Governments, taken collectively, is much larger, absolutely as well as relatively. For a total revenue collection of a little over 90 crores, the provincial cost of collection is 10.19 crores in 1926-27, as against the

similar item of 11.69 crores in 1921-22. *There is a decline, no doubt, even in the provinces from the high water-mark of the post-war inflation. But the relative proportion is still very much higher in the provinces. The suggestion cannot, therefore, be out of place, whether there is no possibility, by combining the tax-collecting machinery of the Government of India and of the Provinces, to make substantial savings in this respect. In other federations, like Australia or Germany, they have managed to effect economies in this direction, without abating in any way the true spirit of federalism in their constitution and administration. Why should not the same be effected in India? The modern tendency has increasingly been, as remarked by the *Indian Taxation Enquiry Committee*,† to divorce administration from politics by making the actual administrators, including the collectors of taxes, secure against the ebb and flow of political sentiment. As the work of tax administration,—including assessment, exemption or rebates, collection and refunds,—is becoming a highly complex task, requiring considerable training and experience, the departments concerned with the levying and collection of the taxes are being entrusted more and more to experts. Political responsibility is, in their case, assumed by a parliamentary chief, who need have no expert knowledge equal to running his department, but who would be competent to represent the viewpoint of the expert to the representatives of the people. Unlike the American federation, which started with very advanced notions about democracy in practice, and sought to realise these notions by making all conceivable offices,—including that of the tax-collector,—elective, we in India have no great reason of apprehend the progress of democracy as likely to militate against efficiency in administration. It is one of the less known blessings of a strongly

o Cp. The *Statistical Abstract* 1917-18 to 1926-27.

† Cp. Op. Cit. Ch. XVII para 554 at Seq.

entrenched bureaucracy like ours, that for its own Safety and security against incompetent chiefs, it evolves codes of regulations that renders the task of administration almost absolutely fool-proof. The new Ministers in the Indian provinces have been under sufficient awe of their Civllian subordinates, well entrenched in the positions they occupy by right of the codes of Government Service Rules, not to take liberties with the day to day administration of the departments nominally in their charge. They are, likewise, duly primed with an adequate sense of their own incompetence or ignorance of such high mysteries of the art and craft of government, not to be too anxious to show themselves off, either before their colleagues, or even before their constituents. The task of administration, in the revenue as much as in other departments of Government, has remained in the hands of the expert in India, and there is no reason to believe that in the near future the course of tradition prevailing in this country will be turned upon itself.

These two requirements being already there, the consummation of further economies in the machinery of tax-collection is not entirely impossible in India. True, the provincial tax-collector has to discharge a multiplicity of duties, which leaves him very little room for studying carefully the minutiae of tax-collection. They have found it out in America by actual experience that :—

> "Conditions of administration are about as important as the rate of taxation in determining the success or failure of property and income-taxes. Under a purely local system of administration, there never was and never will be a generally satisfactory system of assessment of either income or property, for reasons perfectly familiar to us all. Central control of the process of assessment is necessary for the successful operation of either a property or an income tax, and hardly more so for the one than for the other."*

*C. J. Bullock, *Sclected Readings in Public Finance*, p. 482.

And hence the Indian Taxation Enquiry Committee recommended that, so far as the central Indian Government was concerned, a Central Board of Revenue be instituted to administer the Income-tax, Customs, and Salt Duty.† The staffs of each of these large departments would, of course, be different ; but they and their work would be co-ordinated, so far as to effect all possible economies by that device. The *rationale* of such a recommendation is such a degree of centralisation as would ensure sufficient and efficient control, not only to guard against the ever likely danger of tax-evasion; but also to avoid any needless duplication of machinery that could possibly be avoided. In the case of the Provinces, the tradition of Indian administration has, until very recently, been to centralise all functions of administration in a single district officer, whose very name,—Collector-Magistrate,—indicates the multiplicity of his duties The growth of work, and the specialisation of the same, has enforced, even in the provinces, a growing vogue of separating all separable function-from this relic of a vanished age of public administration. New departments are being created in the provinces no less than in the Government of India ; and the tendency of all further progress is bound to emphasise this peculiarity. The reasoning, therefore, of the Indian Taxation Enquiry Committee in the following passage, seems to be at variance with their own conception of the problem before them :—

> "While in the case of the Imperial departments, what has been reviewed is a condition of growth, in the case of the provincial staffs there is found to be a process of disintegration. The Collector has been relieved of a great part of his powers. The Excise Departments, where they have been separated from the Salt, have been

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† Op. Cit., para. 570.

> weakened by the severance, ...
> The remedy in all these cases, as well as in the matter of the isolation of Imperial departments, seems to be to restore the authority of the Collector, but in a capacity quite different from that in which he exercised it in the old days."

As the Committee are themselves aware, the restoration of the Collector to his old position of a district dictator is no more desirable than it is feasible. But they would like to make of him a liaison officer as regards the central departments of revenue concerned in the district ; and in the case of the provincial departments of revenue, making due allowance for the modern tendency of specialisation and separation, the Committee would still make the Collector in each district the controlling authority there in all matters of provincial taxation. I cannot, however, see what possible economies such a reversal of the trend of recent developments would achieve, nor how far it would help to perfect the machinery of federal finance in administration. All the ordinary departments of provincial taxation will have to be under the provincial Finance Minister,the better to enforce the principle of ministerial responsibility, as the corresponding departments in the case of the Central Government are under the central Chancellor of the Exchequer. Their administrative staffs will have to be necessarily different, being chosen for the special requirements of each such department. The District Officer will only be a kind of a fifth wheel in the coach, if he is reinvested with the authority he once used to enjoy in the daily administration of the country, though only as a mere controlling and co-ordinating authority. For a proper working of the federal machine, we shall have to devise as complete a separation of the revenue and expenditure between the Imperial and the Provincial Governments as may be possible under our circumstances and history. Having done that, I cannot but think it would be unwise to undo that very work by re-

instating the Collector into the position of a district dictator; unless such a course clearly guarantees adequate economies in the administration of those departments and the collection of the revenues therefrom, so as to justify our modifying the principles of federal finance to that extent.

Material Development of the Country; Interest on Debt.

The task of the material development of the country seems to lie to the largest extent with the Central Government, at least if we are to judge from the volume of its outlay on such matters as the Railways and the Post Office. The Provinces are solely responsible for the Irrigation Department, and for Roads and Civil Works in their jurisdiction; but it is open to question if the full importance of the roads as a national concern has been yet understood by the Indian authorities.† The provinces spend, in the aggregate, between the Irrigation Works and what are called Civil Works in their territories, over 16 crores, out of a total expenditure of some 90 crores or about 18%. There can be no doubt that Irrigation is a fit subject of provincial activity, even when particular works affect more than one province or state, and as such demand the intervention of the Imperial Government. Whether we consider these as means of adding to the material wealth of the province directly, or whether we regard them as a kind of insurance against the periodical shortage of rains from which India is still liable to suffer from time to time, the overwhelming interest of the local authority cannot be gainsaid. Only, in the event of the existing Indian Provinces being dismembered and redistributed,

* Op. Cit., para. 571.

† The recently published Report of the Jayker Committee on Roads must be regarded as an exception to this remark.

on any of the ideals now being suggested for the purpose, it may be questioned if the new provinces will be able, on their own account, to keep up these works, and to promote them still further. It has already been perceived in many far-seeing circles that the redistribution of provinces wi l involve a considerable blow to the financial autonomy of the new units, assuming that the present principles of distributing powers and functions, resources and obligations, remain substantially unaltered. I hold it to be necessary, as well as advisable, to reconstitute many of the present provinces on some more intelligible principle of local harmony and integrity ; and I think it is by no means impossible to secure this ideal, without affecting either the financial autonomy of the reconstituted provinces, or our general equipment for achieving progressive material prosperity of the country. But that must depend on the readjustment of certain fundamental principles of our present system of administration, which will be indicated to you later on this evening.

In the case of the Imperial Government, the most considerable departments that can claim to be making a contribution in the material development of the nation, are the Post Office and the Railways. This is not the place to discuss the nature and consequences of the railroad enterprise of the Government of India on the general prosperity of the country; nor even the principles which govern to-day the revenue for the State derived from that enterprise. In so far, however, as they are a nation-wide concern, there can be no doubt that the authority in charge of them should be the Central Government. But the conditions under which such an entrustment is implicitly made are : that the Central Government would not so conduct this vast undertaking, as either to lead to any—the slightest—invidiousness of treatment as between

any two or more of the several units of the federation,—whether British Indian provinces, or the Indian States,—or to involve an indirect loss to the community as a whole, because of the undue preoccupation of the State with the success, commercially considered, of that undertaking. There are points in the railways rate-making policy of the Government of India to-day,—and more still in regard to the further expansion of railways,—which have made many an Indian State feel seriously aggrieved. There are cases in the Railway rates now in vogue in this country, which involve, intentionally or otherwise, undue preference even in British India to one class of the railway customers as against another. If the Government of India are to be left in sole charge of this magnificent asset of national development,—as they must be,—they will have to revise radically such principles as have been hitherto evolved for the management of the railways. Above all, the fact that the Government of India are interested so heavily in the financial success of the existing railway enterprise, must not blind them to the economic possibilities of roads with motor traction, or inland navigation on existing rivers, with, if necessary, further canalisation for navigation purposes. So far, the Indian Government have failed to realise these possibilities as they might have. But it is more than likely, that, with the growth of provincial interest and enterprise in regard to improving local means of cheap and convenient transport, the provinces may press forward with schemes and measures, which may compel the Central Government to review fundamentally their entire policy in respect of the railroad enterprise of the country. And, moreover, the local railways known as tramways in the cities, or district railways in larger areas, are and must be within local or provincial jurisdiction, just as the railway running exclusively within the jurisdiction of an Indian State is even

now the concern of that State, subject of course, to such principles of railway policy in general which are common to the whole country. The Government of India would naturally not like the development of these provincial means to an extent, and in a manner, that would conflict with their own vested interests in the matter. It will, therefore be necessary to reconsider the division of powers and functions in this behalf, in any scheme of constitutional reconstruction that may come into effect hereafter, so as to combine the needs of local development of the country, with due regard to the rights and requirements of the several partners in a federation.

In this connection we may also consider the problem of Interest payments by the several Indian Governments. Much of this interest charge is due to capital borrowed for the purpose of constructing these works of material development, and hence the connection between these items. This is not the place to discuss in detail the origin and consequences of the public Debt of India, as also the history of the policy of the Indian Government in regard to the payment of interest and repayment of capital, as and when due. Confining ourselves only to the division of this item of expenditure, we find the Government of India bears an aggregate debt charge, in its latest Budget, of over 49.10 crores, of which 27.47 crores is on account of Railways, 5.74 crores on Provincial Loans Account, 6.21 crores on account of miscellaneous obligations, 0.12 crores for irrigation, 0.66 crores for the Post Office Account, 21 lakhs on other heads, and 5.39 crores on account of geduction or avoidance of debt. The Provincial rovernments pay 3.39 crores by way of interest in the accounts of 1926-27. The aggregate interest charge is not, however, shown quite exactly in these statistics, inasmuch as the rupee figure in

respect of the interest on the same amount of the sterling debt of the Government of India has come down substantially, owing to the appreciation in the exchange value of the rupee. As the Government of India are heavy borrowers every year in respect of their Railways &c., the amount of the Debt is constantly rising ; and hence the saving due to the appreciated rupee, as regards the interest payment on the sterling debt, is not noticed. I have already alluded to the Provincial Governments' claim in the past for an independent right of borrowing, and the gradual concessions made to them in that behalf by the Central Government. The evolution of financial decentralisation in India has too clearly established that right in the provinces to be questioned in principle in any scheme of future constitutional developments. At the same time, it is an open question whether it would not tend to greater economy, if the maintenance of the public credit of the people of India were centralised, for purposes of administration only. The provinces must, indeed, have unquestioned right to demand loans for works of provincial utility and benefit ; and in deciding on the suitability of any given projects, the provincial government must be the sole authority. They must, however, make good to the Imperial Government the interest and sinking fund charges that the latter may have to bear on account of the province in respect of any loan it might ask for. And, of course, no Provincial Government could be allowed to borrow for any but productive purposes, the definition of "productive" being settled in advance, as they do under the present federation in Germany. In view of the peculiarity of India in regard to Famine, the definition of "productive purposes" will have to make due allowance for this peculiarity.

This applies to British India. The provision of productive capital for the development of the

areas under the Indian States still remains to be accounted for. But the principles will then be generalised and common to the entire country that : All borrowing by any part of the federation should be done through the Central Government, though each component part of the federation should be the sole judge for the need of the local objects for which it asks for a loan. This is to be on condition that these objects must come within the definition appointed in advance in that behalf, either by the express terms under the constitution, or by rules made by common consent under some general provision of the constitution in this connection, The Central Government of the country will alone be responsible for the payment of interest and principle of the public debt of the country, taking at the same time all the receipts in the nature of Interest, from whatever source they may come. The provincial governments must make good to the imperial government all the interest and sinking fund charges in respect of any project carried out by them from loan monies borrowed through the Government of India ; and the income of the productive works in each province must, for this purpose, be mortgaged to the extent of this Interest &c. payments. The logical extension of this principle may even involve the transfer of all the Productive Public Works to the Central Government, at least in so far as the income from these works, sufficient for paying the Interest and other charges, is concerned. The balance, if any, must go to the Government, which, under the Constitution, is given that particular class of works. Not only would such an arrangement mean more economical borrowing, and more adequate capital supplies, than is possible nowadays for the lesser administrations to command; but even the much larger question of the general treatment of the public debt, its consolidation and reduc-

tion by such means as conversion, or even annuities, would be very much facilitated, to the immense economic as well as financial advantage of the country as a whole.

Expenditure on National Defence.

On the side of the Imperial Government, the charges in respect of the national defence constitute an exclusive obligation. This is not the place for me to discuss the nature and bearing of our provision for national defence and security, viewed financially as well as economically. I can only refer, once again, those of you who are interested in the matter to the other work of mine on the *Sixty Years of Indian Finance.* I may only add that, considered from every point of view, the defence charges of the Indian Government are excessive, as much with reference to the peculiar needs of India considered alone in that regard, as from the real value received by India from that item of our public expenditure. The Indian Retrenchment Committee, presided over by Lord Inchcape, reported, more than five years ago, that the standard charge for the military defence of India, that can in fairness be thrown on India, must not exceed 50 crores per annum. The purchasing power of the rupee, as well as the exchange value of the same, were, at the time the Retrenchment Committee deliberated and reported, at least $12\frac{1}{2}\%$ below what they since have come to be. Personally, I have never been able to convince myself that the standard figure of fifty crores laid down by the Inchcape Committee was arrived at by an adequate, scientific consideration of the real defence needs of India exclusively. Nor can I find anything in the Report of that Committee which would indicate their full appreciation of the real wastage due to the principles now governing the Army in India, its purpose and strength, its

cost and burden. The actual words, of the Inchcape Committee give, however, sufficient official authority for the feeling, never absent from the Indian political mind ever since it became conscious of its burdens, that the cost of defence in this country is excessive beyond all proportions. Says this body of official investigators, after recommending a total retrenchment of 13·95 crores in the military Budget for 1922-23:—

> "We do not, however, consider that the Government of India should be satisfied with a military budget of Rs. 57 crores, and we recommend that a close watch be kept on the details of military expenditure, with the object of bringing about a progressive reduction in the future. Should a further fall in prices take place, **we consider that it may be possible, after a few years, to reduce the military budget to a sum not exceeding Rs. 50 crores,** although the commander-in-chief does not subscribe to this opinion. Even this is more, in our opinion, than the tax-paper in India should be called upon to pay, and though revenue may increase through a revival of trade, there would, we think, still be no justification for not keeping a strict eye on the military expenditure, with a view to its further reduction."

The Committee had, be it noted in passing, discovered ample examples of laxity in financial administration in the several departments of the army, not to feel a most serious need for a constant vigilance in this part of the public expenditure. But they approached and treated this problem, from the standpoint of mere retrenchment, without paying due regard to the true economy of a nation's provision for its defence. They either did not perceive, or did not adequately express, the disproportion between India's financial ability and her cost of national defence, especially in contrast with the European powers, or any of the Self-Governing Dominions of the British Empire. They gave no adequate consideration to the problem of the naval defence of the country! Confining themselves strictly to the Army expenditure, as

they actually found it in practice; and without suggesting any reconsideration of the basic principles of India's national defence, its means and organisation, they nevertheless recommended the retrenchment to the figure indicated above, with hopes of a still further reduction. The condition laid down by them,—a fall in the rupee prices,—has actually come to pass. Yet the Government of India have not still reduced the military Budget, —which is of course a non-voted item of expenditure--even to the standard figure suggested by the Inchcape Committee of nervous capitalists and zealous Britishers. A glance at the table upon p. would amply confirm this reflection. The Committee, further, did not include in the Military Budget,—as I consider they should have included, —the burden of interest in respect of all the debt incurred in the past for military reasons ; nor did they add to the figure submitted to them the deficit met out of the current revenues for a long term of years on account of the frontier railways, which were originally constructed as a provision for defence. Counting all these ; and providing also for a modest Indian navy for educational purposes, I worked out, in a Memorandum on the Public Expenditure of India submitted to the Inchcape Committee, the fair and reasonable cost of the country's defence on all sides, by land or by sea, **to be not exceeding 45 crores per annum.** There is, you can see, a wide margin still, between what well-informed Indian opinion would concede to be a fair as well as adequate provision for defence, and the figure still insisted upon by the irresponsible Indian Government as the indispensable minium for the purpose, in spite of the appreciated rupee, and notwithstanding the fact that a great amount of what ought to be in fairness included in the Military Budget s rigorously kept outside. There has been, really speaking, no material retrenchment in the Mili-

tary Budget; and that is why Indian public opinion is determinedly critical of this item every session of the Legislative Assembly. If all the possible economies were effected in the organisation and expenditure for India's military defence; if the present British element in the Army in India,—four times as costly as the corresponding Indian unit,—were progressively reduced, so that it disappeared entirely in ten years' time from the beginning of this policy; if adequate scientific provision were made for a first and second line of reserves, which are to-day so conspicuous by their absence or poverty; leaving the true national defence of India to be a most hazardous affair; if a further additional provision were made for a Navy and an Air-force for India exclusively,—the total net cost of that comprehensive provision for defence ought not to exceed Rs. 45 crores. The subjoined table, taken from the work on Indian Finance I have already referred to, illustrates my meaning more clearly.—

N. B. Figures are in crores of rupees.

Military Budget of 1922-23, as submitted to the Inchcape Committee.		Military Budget as it would be 10 years after the adoption of these recommendations.	
Standing Army		Standing Army ..	15.00
Effective	45.28	First Reserve ..	10.00
Non-Effective ..	4.85	Territorial Reserve.	5.00
Home Charges ..	17.35	Navy & Air Force.	5.00
Marine (Net) ..	1.37	Arsenals &c. ..	3 00
Military Works ..	4.65	Extra Interest ..	1.00
Extra Interest ..	17.14	Home Charges ..	10.00
Total..	90.64	Total	49.00
Less Receipts ..	5.64	Less Receipts ..	4.00
Net Cost of Defence.	85.00	Net cost of Defence.	45.00

These are naturally round figures; and the item of Home Charges therein is particularly liable to substantial modification, if the suggestion made for a progressive reduction of the British element in the Indian Army is adopted. The difference, however, may be spread over the other items to account for the normal expansion of the same. I have also worked out, in the work referred to, in some detail, the reasoning and calculations, which give these figures. But whether or not they are taken to indicate the exact margin of possible economies, I shall be content to put them forward as indicating the direction in and extent to which the financing of the defence of India may by recast.

You may well ask: what has this discussion got to do with the main subject of my Lectures, Viz. *Federal finance in India*. The provinces have now no longer their own independent armies, though the separate presidency armies were in existence as recently as the last decade of the last century. But the fact that our evolution towards federalism has dispensed with separate provincial provision for defence,—as in fact must be the case in all soundly organised federations,—must not blind us to the fact that, so long as the Imperial Government of India continues to be liable for this heavy outlay every year, the margin of funds available for the provincial expenditure must necessarily be restricted and inadequate. The revenues that the provinces can be allowed are unavoidably limited by the superior needs of the Imperial Government. Under the circumstances, for the proper development of perfect federalism, the provinces cannot but be vitally interested and concerned in this aspect of the central expenditure. And the interest will deepen as the control of policy in the provinces comes more and more in charge of the responsible popular Ministers; for they will not

have the same sympathies which the British bureaucratic governors of the provinces hitherto felt with the Government of India in providing as they have done for the defence of the country, that is; for the maintenance of the *British Raj* in India. More even than the Provinces, are concerned the Indian States, whose case in this connection is as interesting as it is peculiar, and, in my judgment, unanswerable. I shall deal with that in another connection. But, even in this Lecture, I must remark the other considerations, which are making, or which will shortly make, the British Indian provinces more and more concerned at this item in the public expenditure of the country as a whole. They will not question, I take it, the wisdom, necessity, and economy of centralising the function of national defence, and the incidental cost for the same. But they cannot be denied an adequate share in the provision for that territorial reserve, the absence or inadequacy of which makes our organisation for defence most defective, indeed, in my opinion. They will also insist on a fair share of recruitment for the ordinary standing army coming to them ; and not, as has been the case in the past, recruitment and officering to be confined to only selected areas and peoples. Finally, already, the several Universities in India are projecting schemes of compulsory military training among the Undergraduates within their jurisdiction; and it is inconceivable that the provincial authorities, under which these Universities are situated, would not take any active interest in these developments. The provision of local militia is, as a matter of fact, a state privilege in the United States, and still more emphatically in the Swiss and the German Federations. Hence there would be nothing incongruous or uneconomical for the States and Provinces of India demanding a fair share of attention in this regard. The Government of India

will be unable to resist these several demands from the States and the Provinces ; and the only way I can think of, in which they might be able to satisfy these legitimate aspirations, would be for them to limit their own expenditure in this department rigorously, and pass on the surplus liability, such as it is agreed to be, to the various constituent units of the federation, in whatever proportions or methods it might be agreed to distribute this burden.

The Cost of Civil Administration in India.

The charges in connection with the Civil Administration in general in the several departments come very largely under the Provincial Governments, though the Imperial Government have more than their fair share of these charges. A glance at the comparative, progressive Table of expenditure on p. 185-6 will suffice to show that these charges were, in the aggregate, in 1921-22, Rs. 52 crores, of which the Imperial Government was responsible for Rs. 9·40 crores, and the Provincial Governments for Rs. 42·52 crores, or about 83%. It would be interesting to add that the total civil expenditure of all the Governments in British India, in all departments of moral and material development, fell much below the actually recorded expenditure on the single department of Military Services, in 1921-22, *i.e.* three years after the Armistice.

The figure of civil expenditure has, in the meanwhile, grown in all these Governments, till, in the latest year for which the final accounts are there tabulated, the aggregate is 64½ crores, of which the Imperial share was 11.13 crores, or 17%, and the Provincial 53.63 crores, or 83%. The departments and services included in this all important group it will take me too long to review severally; nor do I think, this to be the right place

to discuss the character and consequences on the public economy of the country at large of these several items of expenditure.

Confining myself to the collective consideration of this group, however; and speaking with special reference to the principles of *Federal Finance*, I cannot omit one general reflection: The cost of public service in this country is excessive beyond all reason. By far the larger proportion of this item consists of the pay and allowances, of an infinite variety, granted to the *personnel* in the several departments. As the salaries and allowances of the public servants in India have been fixed from time to time, with reference, not to the ability of the Indian taxpayer to bear the burden, nor even in correlation with the real service received by the country, but to the needs and demands of the predominant non-Indian element in the public service of the country. For a long long while, the non-Indian element was the most considerable single influence in the administration of the country, even if it was not numerically the strongest; and though with the advent and progress of Constitutional Reforms and the growth of political consciousness in the country, the cry for Indianisation seems to have gathered momentum in the last few years, even now the element of non-Indian origin is considerable and influential as ever. The scales of salary and allowances having been fixed originally, as well as in all subsequent revisions of the same, with regard to these outsiders, it has become a point of self-respect for these Indians who have obtained admission into their ranks not to accept any lower scale of remuneration for themselves. The mischief of this idea is progressive. A vested interest is being rapidly evolved of the Indian public servants of the Indian Government, no whit less insistent than that of the non-Indian

public servant. And, in so far as we may be agreed that the only way to effect true and lasting economy in the cost of administration in this country is to recast altogether, and quite radically, the scales of pay and allowances to the public servants of the higher grades in all departments, the likelihood of a severe internal struggle becomes transparent. The forces of true economy in the cost of administration, and of vested interests of particular classes are fundamentally irreconcilable. And hence I fear this particular aspect of our immediate future, even more intensely than any other problem of a similar nature.

Whatever the danger of this problem, the country will have to face it, if it desires seriously to promote the task of material welfare of the community. The resources at the disposal of the Indian governments, central and provincial, are limited. And the most considerable as well as the most important departments of real nation-building have so far been starved so consistently and abjectly, that the first wave of consciousness of the primary rights of citizenship will force a decision on this point, no matter at what cost. The contrast of the Indian cost of administration,—particularly in regard to the emoluments of the service personnel,—is too glaring to be ignored. Take a single typical case. While the Governor-General and Viceroy of India costs India all told some 17 lakhs per annum, and the provincial satraps follow in like proportions, the chief executive officer of the United States of America costs that country only 2½ lakhs of rupees per annum ; the Prime Minister of Great Britain is paid £ 5,000 per annum, which leaves that individual, after payment of Income and other Taxes, with less than £ 3,500 per annum; the President of the French Republic is allowed about 8,000 pounds per annum, and that of the German

Republic about £ 9,000. Other civil and military officers follow in proportion, and the cost of administration is in consequence increased ceaselessly. True, the lower clerical and menial staff is paid less than starvation wages, perhaps to make up in part for these unconscionable high salaries allowed to the superior, and often non-Indian staff. But that does not assure to the country any the better, more efficient, or more truly economic administration. And as though all this was not enough, there is incessant tendency at work constantly to add to the number of posts in the public service, and also to add to the scale and rate of the salaries and allowances. Between 1913-14 and 1922-23, the total strength of the staff of all grades in the civil services increased by 9.9%, while the pay and allowances of the same increased from 6.75 crores to 13.75 crores, or over 103.7%. In the case of the military services, the increase of staff in the same period was 3.1%, but the increase of salaries and allowances in the same space was from 13.45 crores to 26.99 crores, or 100.2%*

And as though this wholly disproportionate increment was not enough, a Royal Commission on the Public Services in India, presided over by Lord Lee of Fareham, recommended, in 1924-25, further increments at a total cost of nearly a crore of rupees, per annum. No wonder the Provinces never have sufficient funds to press forward with substantial measures of the material development of the country!

It is needless to dilate upon the economic mischief of maintaining, in the public service of a country, such a costly and foreign agency, even if it was giving good value for the salaries and

* For these statistics, Cp. the Report of the Inchcape Committee quoted in the *Sixty* Years of Indian Finance, p. 124.

allowances paid to them. Compared to any other bureaucracy in the world, the results attained by the Indian Civil or Military services cannot be honestly claimed to be markedly in favour of the Joe Sedleys and Tom Newcomes that make up the bulk of these services. I have, however, discussed this matter at greater length, and in all its bearings, in another work on Indian Finance, which those of you who might be interested more deeply may consult on their own account. In the present Lecture it is necessary to add that the existence of this high cost of the administrative personnel, coupled with the limitation or inelasticity of the existing revenue resources, precludes the most enthusiastic provincial government from undertaking and carrying out more ambitious schemes of nation-building, which we all know are badly overdue, but which not the most daring among us dare undertake under present conditions. The comparative statistics of expenditure, provincial and imperial combined, on the following departments in the Table subjoined, will serve to make my meaniug more clear :—

(*N.B.*—Figures are in thousands of rupees).

Department.	1921-22	1296-27	Increase per cent.
	Rs.	Rs.	
Education..	9,00,23	13,03,27	45%
Medical	2,15,26	3,89,33	80%
Public Health	1,57,87	1,88,41	20%
Agriculture	1,97,94	2,41,46	22%
Industries	64,16	1,46,54	128%
Total ..	15,35,40	21,69,02	40%

These are mainly provincialised services; but compared to the increase in the cost of the Police, or of General Administration, this increase is not so very considerable after all. And compared to the need of the country in these very departments, the increase is less than a fleabite, The late Mr. Gokhale declared, on a memorable occasion, in a speech in the old Viceregal Legislative Council, that at the rate at which education was then (1911) progressing in the country, it would take several hundred years before India could have every boy and girl of school-going age educated in the merest rudiments of learning. Since Mr. Gokhale's days, we have been spending a little more liberally in this department, though the increase I repeat, is nothing in comparison to the increase in the cost of Defence, for example. While the single item of Defence accounts for over 42½%, the total cost of education in all the British Governments in India does not amount to more than 14% of the aggregate provincial expenditure, or more than 6% of the aggregate imperial and provincial expenditure. The British Indian Government compares unfavourably in this respect with the more progressive even of the Indian States. While Britain spends over 15/-per head on Education, India even now spends less than *6d*-per head from public funds! These proportions need but to be mentioned to show their utter inequity, At the present rate of educational progress in this country, and confining ourselves only to the case of children, leaving the problem of adult illiteracy aside, India will not be able to have every boy and girl of school-going age educated in the merest rudiments of civilised life, within less than two hundred years. At the present rate, the nation-building needs in the single department of Public Instruction alone, on the basis of abolishing illiteracy entirely in a period of ten years,—a modest ambition, in all

conscience,—would be **at least 40 crores per annum*** With a suitable revision of salaries and allowances in the superior grades, we should be able to meet the increased cost of additional equipment necessary for this task without any additional expenditure. But the above figure, and possibly more, will have to be provided by Government in the near future, if we really mean to build up our nation on a scale comparable to the other civilised nations of to-day.

If the same reasoning is applied to the other developmental departments instanced, the need for provincial expenditure will have to be increased at least by a half of its present scale, or some 135 crores in the aggregate, to make an irreducible minimum of civilsed administration. This can come either from increased taxation and revenues. the possibility of which we have already glanced at, finding no very great promise for the future in the actual situation. Or, we can get the additional funds by drastic economies in the general charges of civil and military services and establishments, sufficient to cope with this demand. The Table attached gives a compara-

* Cp. *Sixty Years of Indian Finance*, p. 166.

M.R.—Figures for rupees and for population are in thousands.

Province.	Expenditure Budget Estimates (1928-29).	Population Census of 1921.	Wealth of Province per capita.	Expenditure per capita.	Total Revenue Collection : Imperial and Provincial (1923-24).	Proportion of Revenue Collection to wealth of the Province.
	Rs.	Rs.	Rs. a. p.	Rs. a. p.	Rs.	
Madras	17,47,52	4,23,19	35 14 4	4 2 0	40,23,69	26
Bombay	16,49,82	1,93,48	75 11 7	8 8 5	41,70,99	28
Bengal..	11,19,62	4,66,95	40 9 8	2 6 3	51,52,43	27
United Provinces	12,01,30	4,53,76	47 8 3	2 10 5	39,01,81	18
Punjab	12,77,03	2,06,85	48 0 0	6 2 9	30,81,12	30
Burma..	11,78,46	1,32,12	36 4 7	8 14 7	21,16,32	45
Bihar and Orissa	5,87,96	3,40,02	46 2 9	1 11 8	19,88,94	120
Central Provinces	5,82,07	1,39,13	58 3 1	4 3 0	13,02,64	16 *
Assam	2,89,29	76,06	59 1 7	3 12 10	6,87,89	15

* This Table has been compiled from the *Wealth and Taxable Capacity of India*, by the present writer and Mr. K. J. Khambata.

tive view of the wealth and taxable capacity of the several provinces, and their existing volume of expenditure. It is true the provinces *inter se* vary considerably in the costliness of their administration. And to that extent, retrenchment will have to be effected rather drastically by some of the provincial Governments concerned I recall, however, the example the Punjab, which has achieved a very praiseworthy record, even with the present limitations, and in this short period we are now reviewing. I see no reason why the other provinces should not be able to accomplish as much for themselves. On the other hand, as I have observed in summing up the present position in respect of Federal Finance in India in the *Sixty Years of Indian Finance*:—*

> "A complete separation of finance, both on the revenue and on the expenditure side, without a link or a hyphen, must be postulated as the *sine qua non* of any possible and satisfactory solution. On this basis, the desire of the Imperial Indian Government to prescribe and enforce some common standards of administrative efficiency and material development in all the several provinces will have to be abandoned, not because it is questionable, but simply and solely because it is outside the scope of the duties and ability of the central government."

On this line of reasoning, while the provincial and central finances might be completely separated, the actual course of administration and development in each province would have to be left to the provincial authority. No one, of course, would be suffered so to govern the province as to militate against the national solidarity, or to deny to any citizen what is by common consent agreed and accepeted to be the irreducible minimum of civic rights. But within these limits, there is ample scope for that reconstruction, *ab initio*, of financial arrangements, which would

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* Op. Cit., p. 483.

most completely realise in India the ideal of Federal Finance. I shall endeavour to give a skeleton scheme in the conclusing Lecture, which would, I think, approximate closely to this ideal.

SUMMARY OF LECTURE IV.

Summing up the discussion in this Lecture, we find:—

(1) That the aggregate Public Expenditure of the Government in India, both Imperial and Provincial, leaves considerable room for retrenchment and readjustment, so as the more economically to govern the country, the more fully to develop its material resources, the more truly to promote the welfare of its people.

(2) That though there has been a considerable improvement in the public expenditure on the several departments of national development, as viewed in the bare figures of money spent, the true criterion of such an improvement is not supplied by money figures alone; that the mere increase over several years in the amount spent on a given purpose does not truly represent the improvement in the material results on anything like a corresponding scale; and that, consequently, it is necessary, in the first instance, to define the irreducible minimum of material benefit the people of the country are entitled to expect from the activities of their Government; next, to ensure that adequate provision is made for these irreducible minima of requirements; and then only to institute comparisons like the above.

(3) That any likely scheme of financial reconstruction in India will not alter very materially the existing division of functions and obligations as between the Imperal and the Provincial governments; but that the volume of expenditure of either authority on each of the several departments in their charge will have to be basically reconsidered, so as not only to avoid the present charge of excessive costliness in the Indian governmental machinery, but also to guarantee a more scientific consideration of the needs of India as a whole, as well as of each of its provinces and states.

(4) That, on the assumption foregoing, the Imperial Government's Budget will have to be materially curtailed to a maximum of 110 crores expenditure, and the provincial government's increased to 135 crores at least, making a net total increase of Rs. 20 crores at least per annum. This presupposes effect having been given to such reduction in the scale of salaries and allowances in the superior ranks as are necessary conformably to the needs and the ability of the people.

LECTURE V.

Finance and Economic Relations with the Indian States.

I am afraid the Lecture this evening will have to be more than usually long, and I must, therefore, bespeak your patience and indulgence in advance, as I may have no time at the end to do so.

The problem of Federal Finance has so far been considered exclusively from the standpoint of British India. Such a mode of treatment, however, though making for coherence and simplicity, overlooks the most vital point of the Indian national life: that all parts of the country are fundamentally one, indissolubly united with one another, and consequently impossible to be marked off into watertight compartments, even on so wide a line of division as that between British India and the Indian States. I am, indeed, aware that jurists of such eminence as Sir Siva Swamy Iyer are of opinion that the Indian States can never be so completely assimilated with the rest of India, as to be justly regarded as fit and equal partners with British India.* I regret time will not permit me to examine in detail the argument of this school of writers, even if I felt myself competent to tackle the juristic, political, or even the purely structural aspect of this problem.

I must mention, however, in extenuation, if you like, of the argument hereafter to be unfolded in this Lecture, that Sir Sivaswamy and people of his way of thinking seem to me to give an undue importance to the letter of the Treaties, to the

* Cp. The *Indian Constitutional Problems*, by Sir Sivaswamy Iyer, Chs. XI. to XIV.

personal factor of the ruling Princes, and, above all, to the working difficulty of devising some form of political machinery, whereby the United States of India could be formed in a veritable Federation, embracing the Indian States as well as the present British provinces. Without denying the fact that the Government of India have come to be, by the irresistible course of events, the supreme authority in India; without worrying ourselves with the exact answer to the question whether the powers now wielded by the Government of India are the outcome of definite parliamentary enactment, or the creation of special treaties or engagements; or the gift of the King's ancient, though obsolete, prerogative; or the continuation, in part at least, of the authority of the Mughal Emperors,—the fact of that unchallenged supremacy is all important for our present purposes. From that supremacy has flowed the fertilising current of a slow federalism, which has until now watered largely the British provinces, but which I see no reason to be kept away from the Indian States as well. The convention has no doubt grown up and been made much of, in recent years, not to intervene in the domestic affairs of the States, without grave cause to apprehend a breach of peace, or without serious reason to believe the interests of the governed being imperilled without chance of remedying. But the fact that there have been interventions of the supreme authority to set right even the purely domestic abuses of particular states; that, despite the actual words of the Treaties &c., Government have admitted exceptions to the general convention of non-intervention, on either side of the line; must suffice for the argument that the relations of the Indian States and the rest of the country are so close, so numerous, so constant and indispensable, that anything that promotes a closer co-operation and

a more effective concert of action among them, cannot but be welcomed by all parties concerned. If the existing relations have been fashioned out of the raw material provided by subsisting treaties and acknowledged precedent, even though by an interpretation not always or strictly in accord with the letter of the treaties, there is no reason to question that a still closer relationship may be brought about by the same means in the first instance. What we want is the result; and, if that can be assured, we need not cavil at the means accomplishing it.

"None of us would venture to say that the day of the Indian States is past", says Sir Sivaswamy Iyer! But he seems to draw rather a doubtful conclusion from this his own perfectly unassailable proposition. The role of the States, whatever it may have been in the past, is going to be, in the near future, in no way dissimilar to that of the rest of the country: that is, if we would not make the mistake of confusing the States with their Ruling Princes. Sir Sivaswamy Iyer does, it seems to me, make this mistake, when he attaches so great an importance to the personal factor influencing the Princes' attitude to the recent political developments in India, and their likely consummation. That the Princes' sense of their relative importance among themselves might stand in the way of making up a body to represent adequately, efficiently, and withal legitimately, the interests of their States, in the common councils of the Federation, makes a plausible argument only if we conceive the problem as affecting and concerning the Princes only, and not as one affecting the States of which the Princes may be an important part. The problem of the Indian States, in the accomplishment of the Indian Federation, has, I venture to submit, been considered unduly from the stand-point of the

Princes in relation to the Government of India. At the utmost, and that too in recent years only, consideration has been given to it from the standpoint of the States and the Indian Government. Rarely, however, if at all, have statesmen and thinkers on the matter allowed for the fact that, behind and above the States in each case, are the people of those States, as also the people of the British Indian territories; that a proper, satisfactory solution can never be obtained so long as the people on either side are treated as ciphers; so long, moreover, as the problem is unduly narrowed to merely the relations between the governments,-or the governors,-on either side. For my part, I conceive the problem to be not only a triangular, but a pentangular question, in which the Government of the States and of India make two obvious and important sides; the peoples of the States and of British India make two more sides, less obvious perhaps, but not less important; and the Rulers or Princes make a fifth side, in so far as we cannot overlook their personal factor. I think the day is past when the Ruling Princes of India could effectively make of themselves an order—an additional estate of the realm—by themselves. But it is not too late for the Princes of India to learn even now the lesson of their age, to realise the vital need of their country. We cannot afford any more lines of division or difference in this already too intensely divided and distracted nation. If, at this crucial moment, the Princes will identify themselves with their states, and make their governments identify themselves with their peoples, there is nothing, as far as I can see, to prevent their securing every one of their reasonable demands, in a full and equal federation of the states and provinces of India. Viewed in this manner, with due importance being given to the popular element, I see no difficulty insuperably interposed in the way of accomplishing federal institutions,—Executive,

Legislative and Judicial,—which would fully preserve the just rights of each individual partner in the federation, at the same time equipping the collective federal body with powers, authorities, and resources equal to the maintenance of the nation's integrity, as also to secure its moral and material development in keeping with the importance of this people in the family of nations.

It is not for me, in this Series of Lectures, to outline a working scheme of such federal institutions, as would adequately give effect to to the principles and conditions I have been trying to indicate. The learned jurist I have already quoted and referred to is perfectly right in disposing of the contention, made of late in certain quarters, which would make the Treaties between the Indian Princes and the Government of India *a purely personal relationship* between them and the King-Emperor of India.*

"It is contended" he says, "that though the Indian Princes now deal with the Governor-General-in-Council, it is only because he is the agent and representative of His Majesty the King-Emperor, and not because he is the executive head of the Government of India. The theory of a *vinculum juris* between the Indian states or princes and the British sovereign, otherwise than in his capacity of sovereign of British India, has no basis in constitutional law. It is, of course, quite possible to distinguish between the Viceroy as the representative of the British Crown and of the Imperial Government, and the Governor-General as the executive head of the Government of British India........ ......When responsible Government is introduced, the distinction between the two capacities will emerge into

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*Cp. Sir Sivaswamy Iyer, Op. Cit. p. 210 et seq. Sir Sivaswamy differs in this matter from Sir A. B. Keith, as he himself very clearly points out. But, for reasons adduced by Sir S. Iyer, I cannot accept the Keith view or analogy. The point seems to have been raised in the Princes' case, as submitted by Sir L. Scott to the Butler Committee, if press reports may be relied on. Before, however, the Butler Report is published, and action taken thereon, nothing can be said decisively on this question.

notice. Such a distinction is not unknown to constitutional law; but as regards the question with whom the Indian princes have entered into treaties, it is not correct to say that the treaties were entered into with the Crown irrespective of the sovereignty of British India."

Sir Sivaswamy proceeds to give trenchant analogies and arguments to prove that the contention is absolutely untenable, even though a deservedly great jurist's authority could be cited in support of it. For, as he very pertinently urges, could the treaties made with and by the present monarchical government of Britain be considered to be not binding on the republican England, should that country change its constitution so far as to dispense with the hereditary chief magistracy of the Empire? The point has, it seems obvious, at all arisen, because, as the same writer most apositely points out, some Princes seem to have taken alarm at the rapid strides democratic institutions and responsible government seem to be making in British India. They cannot disguise it any longer from themselves that what is happening in British India to-day might very well happen in their own territories to-morrow. The day of absolute personal rule is over; and the sooner the Indian Princes realise that, the better for themselves, their states, and their peoples, not to mention British India and its peoples. The progress of self governing institutions in British India need not necessarily be a danger signal to the Princes, if they only will realise the spirit of the times they live in, and appreciate at the full value the fact that they are themselves of India, and Indians. They might have reason, or prejudice,— to justify the apprehension that the growth of self-government in British India would mean a progressive decay of their own rights and privileges. No one can, of course, assure them to the contrary, if they think of these rights and privileges as apertaining to them in their own personal capacity. But in so far as their rights

and privileges are a matter of solemn engagements between their Government and the British Indian Government, each representing its own people, Sir Sivaswamy Iyer might well point out that:—*

> "Whatever encroachments on their rights and privileges there may have been in the past have been made, not by the people of British India, or any government responsible to them, but by the irresponsible and bureaucratic Government of India."

If only the Princes or their advisers would carefully consider the specific cases of such encroachments in each instance, they would not only realise the inherent justice of this retort, but even perceive a deeper fact of the history of India in the last three quarters of a century, viz., that the entire government of this country has been conducted for the open or secret benefit of the British capitalist element; and that whatever Indian interest came into conflict with the interests or demands of that element,—whether it was the cotton industry of Bombay, or the Opium revenue of the Malwa States; whether it was the general fiscal policy of the country as a whole, or the special manifestation of economic parochialism in respect of a Government of India Guaranteed Railway Company, operating in part in an Indian State,—had to be sacrificed by the tools of that element in India. If the Indian Princes, or rather the Indian States, are to obtain any guarantee of keeping their just rights and privileges, *vis-a-vis* the rest of India, in tact, they must learn to trust more and more the people of British India, as also their own Indian advisers and Ministers, rather than the non-Indian counsels and influences that seem so far to have swayed them. Responsible statesmen and authorities in British India have, indeed, admitted the fact of a silent change having come over the interpretation

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* Op. Cit. p. 200.

and enforcement of the treaty obligations as between the States and the Government of India. But the change, such as it really is, is the outcome of the irresistible tendencies of our age, which the Princes cannot fight against, try however they might :—

"There is no doubt," said Lord Chelmsford, in one of his public speeches," that with the growth of new conditions and the unification of India under the British power, political doctrines have constantly developed. In the case of the extra-territorial jurisdiction, railway and telegraph construction, limitation of armaments, coinage, currency and opium policy, and the administration of cantonments,-to give some of the more salient instances,—the relations between the States and the home government have been changed. The change, however, has come about in the interests of India as a whole."*

Here precisely lies a point that, I venture to opine, Sir Srivaswamy has not allowed sufficiently for. If the treaty position with the States has been insensibly changed from the day it was first created, that is the result of those positive forces for the unification, and federation of India, which the Princes as well as the Indian publicists will be most ill-advised to fight against. Their best and the most profitable course consists in a hearty, unreserved adoption of the forces that have come to stay ; and so to handle the further developments in these very same forces as to minister to the utmost advantage of the country as a whole, as much as to that of each constituent part thereof. Sir Sivaswamy Iyer, while admitting the fact of this change, would yet not draw the obvious lesson of that change : *Viz.* expediting the tendency to unification, so as to accomplish the material development of the country as rapidly and intensely as our backwardness in the race demands.

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* Lord Chelmsford's Speeches Vol. II. p. 278 quoted in Sivaswamy p. 206.

To consider the Government of India, in the face of these facts, as a unitary Government, in fact as well as in the future, is to misread altogether the vitality of political forces. The rights and concessions the States have contended for, in their economic relations with the Government of India, and on the strength of their existing Treaties, engagements, conventions or precedent, are, in my judgment, in no way likely to suffer, if they base them also on the logical requirement of scientific federation, as I shall endeavour to show in the remarks that follow, by examining in outline each specific group of claims on the financial side, and economic relationship in general. The exact political machinery, by which deliberation, consultation, or decision on such matters may be federally arrived at, or action jointly taken, is a matter of constructive statemanship in politics, with which, as I have already declared, I am not concerned in these Lectures. Suffice it for me to add that, given goodwill and proper understanding of the nature and bearing of the problem and the parties on either side, it would not at all be impossible to arrive at a satisfactory division of powers and functions between the central federal Government, and the local constituent units, whether the latter are the present provinces or their reconstituted fragments, or the Indian States or their reconstituted local unions for more effective co-operation in a federal organism. This last device I consider the statesmen and jurists who have so far considered this problem have not sufficiently allowed for, most probably because their outlook was needlessly narrowed by their thinking of the Princes rather than of the States or their peoples. The States, no doubt, vary enormously *inter se*, in respect of area wealth and population, as also in respect of treaty rights. But if the smaller States, which make such a grave difficulty for Sir Sivaswamy Iyer; were to be grouped into local unions or confederations

of their own,—e. g., all Kaithawar States, of an area and population and jurisdiction below a prescribed standard, to be a confederation and a unit by themselves for purposes of representation in a federal Chamber of Legislature,—much of the technical obstacle would be removed; and the way be made clear for a true federation, in which the States or groups of States, would receive the same just and equal treatment that the provinces or their fractions would receive, for the common benefit of all.

I shall now proceed to consider the specific cases in which the States feel themselves aggrieved by the existing policy of the Indian Government in that behalf, and for which I consider a proper federation to be the correct remedy.

Subjoined is a table showing the chief items in the revenue and expenditure of the Indian States by way of illustration.

Revenue receipts of some Indian States.

Principle Heads.	Hyderabad. 1337-F.	Mysore. 1927-28.	Baroda. 1926-27.
	Rs.	Rs.	Rs.
Land Revenue	3,00,00,000	1,26,02,000	1,16,64,500
Forest	17,99,600	34,82,000	6,07,056
Customs	1,32,34,285	..	7,51,296
Excise	1,56,66,800	61,39,000	28,85,548
Stamps	18,70,000	20,40,000	11,16,753
Income-tax & miscl. ..	..	15,02,000	6,41,152
Salt	..	..	..
Registration	2,50,000	3,45,000	1,80,728
Interest	42,55,000	6,94,000	13,65,153
Civil Administration ..	..	2,95,000	4,09,846
Public Works	..	1,48,000	5,14,551
Commercial Services.			
Railways..	32,92,022	20,00,000 (net).	7,97,345
Irrigation	65,000	26,61,000	34,196
Defence	..	54,000	..
Miscellaneous	2,50,000	..	24,23,838
Extraordinary	29,16,667 (Berar rent)	2,00,000 (assigned tract revenue).	2,41,980 (Tribute and fix Jamabandi).
Protection	..	1,92,000	1,06,019 (Judicial fees).
Mines	1,33,000	12,33,000	..
Opium	13,00,000	..	5,60,735
Electricity	49,310	..	2,10,870
Post	8,50,000	..	..
Industrial	15,284	85,000	..
Development	..	3,38,000	..
Mint	1,00,000	..	..
Paper Currency ..	3,50,000	..	..
Exchange	1,00,000	..	..
Other	1,25,000 (Transfer from Insurance).	..	1,80,099 (Village Board and Vashi Panch).
Total ..	7,68,22,000	3,40,10,000	2,46,61,665

Revenue receipts of some Indian States.

Principal Heads of revenue	Kashmir. 1384-85-F.	Travancore. 1927-28.	Bikaner. 1927-28.	Gwalior. 1 July 26 30 June 27.
	Rs.	Rs.	Rs.	Rs.
Land	53,60,000	40,89,300	14,20,600	98,00,000
Forest ..	80,50,000	13,59,200	..	3,20,000
Customs ..	40,25,000	30,39,000	20,50,000	31,50,000
Excise ..	3,59,000	50,70,800	4,35,000	12,50,000
Stamp ..	5,48,000	26,90,000	1,16,200	6,70,000
Income-tax ..	..	6,04,300	2,56,600	8,25,000
Salt	..	16,70,700	53,100	3,12,500
Registration ..	..	8,20,600	14,300	..
Interest ..	4,00,000	8,47,800	30,000	32,41,000 (funded and normal).
Civil Administration ..	5,91,000	13,44,400	4,85,200	2,43,500
Public Works..	11,03,000	*3,63,000	1,97,500	..
Railways ..	..	*2,00,000	4,00,000	17,00,000
Irrigation ..	..	1,57,100	60,200	4,25,000
Defence ..	2,00,000	1,100	..	..
Miscellaneous .	3,26,000	1,02,500	11,000	10,47,500
Extra-ordinary.	70,000 (Pro. in Br. I.).	4,100 (Palace).	1,00,50,000	14,539 (Deccan Pro.).
Protection ..	..	..	..	..
Mines	..	..	1,98,500	..
Opium ..	..	..	..	..
Electricity ..	79,000	..	..	..
Post	..	..	..	4,20,000
Industrial ..	28,00,000	..	..	1,25,300
Development .	..	..	..	4,05,700
Mint	..	..	..	..
Paper Currency	..	..	..	..
Exchange ..	..	..	..	..
Other	..	..	1,48,500 (Sale of State Pro.).	58,00,000 (For Pro. Wor. from last year's
Total ..	2,39,11,000	2,23,21,000	1,95,26,700	2,97,49,739

* Net Receipts.

* The items are not given under the same heading in all the different states here tabulated; but the author has tried to give an appearance of uniformity by combining like items and presenting the whole in a standardised form.

Expenditure of some Indian States.

Principle Heads.	Hyderabad. 1337-F.	Mysore. 1927-28.	Baroda. 1926-27.
	Rs.	Rs.	Rs.
Land Revenue	65,21,100	28,12,000	21,95,594
Forest	9,12,200	13,10,000	1,21,276
Customs	17,99,200	..	3,59,189
Excise	31,22,300	4,00,000	(included in Custom).
Stamps	1,59,000	90,000	73,112
Registration	1,19,600	1,54,000	58,962
Income-tax & miscl. ..	..	87,000	(included in Custom).
Salt	..	..	..
Interest	22,51,000	35,45,000	44,709
Debt Redemption ..	10,00,000	18,78,000	..
Mint	2,46,800	..	..
Paper Currency ..	56,900	..	..
Exchange	70,100	..	..
Post	11,90,000	..	..
Payment to the Rulers..	50,00,000	26,10,000	20,29,422 (Palace).
Civil Administration ..	2,48,16,600	37,35,000	30,88,676
Public Works	92,78,800	28,44,000	28,86,794
Political	4,22,200	..	10,57,176 (Prince and Hazur Raj)
Railways..	2,27,000	..	..
Irrigation	33,44,300	..	64,858
Other Com. Ser. ..	2,42,600	..	3,28,025
Army	72,54,700	52,78,000	21,53,963
Miscellaneous	4,02,300	6,48,000 (Local Self also).	7,73,819
Development	11,08,400	59,77,000	1,00,017
Famine and F. Ins. ..	16,25,000	..	..
Opium	1,22,600	..	28,512
Mines	56,100	2,07,000	..
Reserve	11,16,000	..	..
Protection	..	39,68,000	49,74,350
Total ..	7,24,19,800	3,55,43,000	2,04,19,363

Expenditure of some Indian States.

Principle Heads.	Travancore. 1927-28.	Bikaner. 1927-28.	Gwalior. 19 - .
	Rs.	Rs.	Rs.
Land Revenue	10,10,000	10,50,600	4,45,618
Forest	32,75,000	8,58,800	..
Customs	2,82,000	80,900	1,78,862
Excise	..	4,10,600	1,14,274
Stamps	..	92,200	9,820
Registration	..	2,90,900	..
Income-tax & miscle. ..	..	33,400	..
Salt	..	1,96,800	..
Interest	..	3,30,700	27,000
Debt Redemption ..	..	1,86,600	..
Mint	..	..	..
Paper Currency ..	..	..	..
Exchange	..	..	..
Post	..	..	..
Payment to the Rulers ..	..	..	..
Civil Administration ..	21,57,000	13,46,500	13,50 952
Public Works	38,29,000	95,67,900	15,22,873
Political	46 41 000	35,39 100	7,85,296
Railways	4,99,000	2,77,700	62,69,089 (devasthan)
Irrigation	..	..	27 53,480
Other Com. Ser. ..	..	..	13,176
Army	12,08,000	..	..
Miscellaneous	38,76,000	13,61,800	7,36,657
Development	3,45,000	9,56,200	1,84,312
Famine and F. Ins. ..	18 32,000 (sericulture).	..	75,76,001 (capital charges).
Opium	..	..	45,51,574 (repayment, etc.).
Mines	..	..	1,38,976
Reserve	..	..	..
Protection	32,49,000 (Edu. Medi. Sani..	..	..
Total ..	2,61,27,000	2,05,81,800	2,02,57,960

It will be remarked that the States have pretty nearly the same items of revenue and expenditure, as the British Indian Government. In point of theory, and to a large degree in point of fact, the States have always had a separate purse, each its own ; and so there has not been quite the same problem of distributing the resources and obligations between them and the Government of India, as there has been between the latter and its provinces. Their Treaties, however, have affected certain items of their revenue—such as salt or opium,—and expenditure directly ; and more still by the insensible changes of history, emphasising the process of consolidation. I shall notice the most considerable of these in a moment ; for the moment let me add that, corresponding to the contributions made by the British Provinces to the Government of India, the States has been paying all along their history tributes to the latter, which now aggregate some 85 lakhs of rupees, quite apart from the large slices of territory made over in perpetuity to the British Government by the States. In these two respects, then, the position of the States is quite the reverse of the Indian Provinces ; for the provinces had, until 1870, no separate purse of their own, nor were they paying any contribution to the Central Government corresponding to the tributes from the States. In the last sixty years, moreover, while the Provinces have gradually obtained a greater and greater accession of powers and resources, the States have suffered insensibly in the process of consolidation, by their powers of internal sovereignty being vitally limited, and their resources being indirectly curtailed by the progress of events and changes of policy in the major partner in the federation.

Though the States have very nearly the same sources of revenue as the rest of British India, the former feel the process of consolidation has so

developed as to prevent them from making the utmost of these their own resources. Without indulging in any special pleader for the degree of good government in the States collectively, this much, I think, may safely be admitted in fairness to the States,—or the more progressive among them, that the lack of adequate resources, resulting from this indirect curtailment, imposes a most effective check upon their ability to improve their administrative efficiency, or promote the material development of their territories. Take the case of the most important of the revenue resources in the States. While the Land Revenue is assessed and collected in each state according to the law and custom in vogue therein, the States collectively have more than one grievance in respect of that other great example of Direct Taxation in India: Taxes on Income. As already mentioned, the Indian Constitution assigns, under existing arrangements, the whole of the proceeds from this source to the Central Government, in marked contrast to the general practice in respect of such taxes in other federations, and in opposition to the trend of development in British India itself. It has already been pointed out that these arrangements have never commanded the approval of the British Indian provinces, ever since they have come into vogue; and it is not too much to prophesy, I think, that in the next reconsideration of the question of distribution, the provinces will make a most strenuous demand for the proceeds of all direct taxation for themselves. For the States, the grievance is totally different in character; though they also would re-echo the present arguments urged by the provinces. As the Indian Government have adopted the principle of deducting their Income-Tax on every income within their jurisdiction at the source, it follows that all incomes originating in British India are made liable to the Indian income taxes. It is true, incomes originating in British

India,—*e.g.* interest on the sterling debt of India, or the pensions of the Indian public servants paid in Britain,—are exempted from the Indian tax, though the legality or the equity of this exemption is impossible to perceive. But, to make up, perhaps, for this rather unconscionable exemption,—costing India to-day nearly two crores per annum by way of loss of revenue,—the Indian Government allow no exemption to the incomes arising in British India, but due to the Indian States, or their residents. This is in flat opposition to the dictates of international law and convention, just as much as it is against good sense and diplomatic amenity in India itself. I have already referred, I believe, to the advice of the International Experts appointed to investigate the problem of Double Taxation, as also to the recent innovation in the British practice, which charges only half the normal British rate on incomes earned in the Dominions. The moral, however, of these arrangements and conventions seems to be lost upon the Government of India, at least in regard to the Indian States. They allow no such exemption or consideration to the incomes arising in British India, but due and paid in or to an Indian State, or even to its Ruler personally; though the practice is generally recognised in international usage to exempt the income of the reigning sovereign of a friendly state from the Income Taxes in vogue in another state on income due to the reigning Prince arising in such other state. No Indian State would be suffered, even if it has an income tax of its own, to levy that tax on the salaries, etc., of the British residency officials in that state. Does not the same principle of diplomatic courtesy apply to the case of incomes derived by the Indian Ruling Princes from investments in British India. Some of the Indian States or Princes have invested heavily in the British Indian securities, public as well as private; and the absence of this courtesy or con-

sideration to the States or their Rulers makes the latter feel justly indignant, especially as in many cases these investments were made at moments of very sore need of the Government of India. The Indian Government would not be open to this criticism, if they were charging their Income Taxes on all incomes arising within their jurisdiction, no matter where any such income was finally enjoyed. But inasmuch as they have deliberately allowed a considerable portion of such income to be exempt from their taxes, precisely on the ground of such incomes passing outside the jurisdiction of the Indian Government because of the non-Indian domicile of the receipient of the income, the States and their Rulers feel the treatment meted out to them to be hard beyond words. Again, while the reserve funds and investments of the provincial governments are exempt from the Government of India's Income Taxes, similar funds or investments of the States are not exempt from such taxation. How then are they really to be regarded as equal members of a common federation? The capital invested by a few,—very few,—of the more prosperous States, or their rulers, in British Indian industry or securities, benefits that territory from the mere fact of that investement. Given the needs of India in respect of industrial capital, the Government of India have offered in the past every concession to attract foreign capital, even to the extent of managing their currency system, in part at least, so as to conciliate the susceptibilities of the capitalist from abroad. It seems, then, to be as unwise, as it is unjust and uneconomical, to deny the States what is their due in international courtesy, diplomatic usage, existing precedent, and economic advisability.

To those unmindful of the argument hitherto developed,—or unwilling to recognise its force,—the rejoinder is very simple : Let the States impose

their own separate Income Taxes ; and, if they feel any grievance against the British Indian Government in respect of the latter's administration of *their* Income Taxes, let the States retort in kind, and make the Government of India realise by actual experience the unwisdom of such a policy. Such a rejoinder is, however, more easy to make on paper, than carry out in practice. Taken collectively, the States are in no position to expect from their own taxes on incomes, arising or enjoyed within their territories, such a substantial addition to their resources as materially would add to their administrative efficiency and service. As a matter of fact, with the exception of Mysore, Baroda, and Patiala, no Indian State has yet thought fit to introduce a direct tax of this *genre* in its financial system. The reason is quite clear. The States financiers know full well that either the tax will fall on the public servants of the State,—which would only intensify the outcry for increased emoluments to such servants ; or it would trench on that industrial capital and skill which still persists in being invested in their rather backward territories. Taken collectively, the States afford even yet a practically virgin field for economic development. But they badly need for such a purpose a sufficiency of capital, which any such proposal for local taxation is very likely to scare away. Owing to their comparatively poorer administration in the past, the States have, as it is, already lost by emigration a goodly proportion of their native talent and enterprise, to the benefit of British India. The more sagacious among them are, therefore naturally reluctant to take any steps, at all likely to frighten away the still remaining capital and skill, or to jeopardise the advent of fresh instalment. Hence their inability to think seriously of their own income taxes, even as retaliatory measures. The bulk of the States' people are much too poor to afford any well-founded hope of

substantial yield, even if the exemption limit were much lower than in British India. In so far, then, as the industrial development of the States is likely to be jeopardised by the States instituting their own Income taxes, if only as a measure of retaliation against the British Government; or, per contra, in so far as the present principles regulating the administration of the British Indian Income Taxes would deter the States or their Rulers from investing any capital in British Indian industry or public security, the country as a whole becomes the poorer.

This is, moreover, quite apart from that other danger of such an argument for retaliation: *Viz.* that, if resorted to, it would undermine such sentiments of mutual goodwill as there already may be in existence, thereby rendering the possibility of mutual co-operation in the common task of national development more than ever difficult. The basic idea of the International Experts' recommendations for conventions regulating the incidence of Income Taxes, as between countries which are in intimate financial intercourse with one another, becomes doubly applicable to this matter in India, where the entire country would be a gainer if the levy of this tax was made more in conformity with the true principles of Federal Finance.

I cannot pause in this Lecture even to indicate the outline of the precise mechanism, whereby these conflicting ideals may be simultaneously accomplished. I may only add that whatever concession the British Government of India make to the Indian States in this behalf need be no loss to the former, if only they would take measures at the same time to bring under their own taxation such incomes, arising in India but paid outside India, as now escapes that taxation. It is possible the Imperial British Government might object to this

device, if rigorously insisted upon by the Government of India; but in that case the latter have sufficient bargaining power still left to them in the analogy of the British practice in regard to incomes arising in the Dominions. If that practice is adopted by the Imperial British Government in respect of British Incomes arising in India, the Government of India would have a sufficient margin of taxable income opened to them afresh as not to make them incur any substantial loss by reason of the concessions made to the States. On a fair calculation, and on the present basis of the British Indian Income Taxes, the compensation, or refund, to the States capital invested in British India cannot possibly exceed Rs. 2 crores per annum; and that amount,—and much more, besides,—can be easily saved by the Government of India, if they would only close up the present loopholes to the non-Indian having incomes arising in India to escape taxation.

I have, you will note, not mentioned so far in this argument, that aspect of the problem, which is expressed in the term "Double Taxation." Only a few Indian States have had, so far, their own Income Taxes. It would be interesting to know from them if there are composite businesses common to such States and the adjoining British territory, which give rise to the problem of "Double Taxation." The Bank of Baroda has a flourishing Bombay branch; and very shortly transport companies on the road will operate on a large scale in areas common to the British and the States' Governments, if they are not doing so already. The problem of "Double Taxation" might be nipped in the bud in this country, and as between its several parts, if measures of the type indicated above are adopted in advance as part of the constitutional financial machinery of the Indian Federation.

Serious as the States' grievance in respect of the taxes on incomes threatens to be in the near future, its gravity and consciousness is nothing in comparison to that of the Indian revenue from the Customs Duties. Under the existing constitution, the central Government of India claims the entire revenue from the Customs Duties, which, so far as the British Indian provinces are concerned, is in perfect accord with the recognised principles and practice of Federal Finance; but which involve a serious complication, in so far as the Indian States are concerned. The States feel acutely on this subject; since, though many of them still continue to levy their own Customs Duties, the entire position in respect of this Revenue has been so manœuvred that they cannot but feel themselves materially aggrieved. Representations have been addressed by the States, individually as well as collectively, on specific counts as well as on occasions when the entire fiscal policy of the country was admittedly under reconsideration; but their representations have been turned down, either because the authority addressed had no jurisdiction to listen to these representations,—as happened in the case of the Fiscal Commission,—or because the officers and Departments concerned in the Government of India were too prejudiced to do the States' case full justice. The rules of international etiquette, as also of interpreting specific Treaty provisions in this regard, have been so vague and one-sided, that the States relying on them have unavoidably failed in their quest. One reason of their failue hitherto was the absence of any collective organisation among the States themselves, carefully to think out and prepare the States' point of view, and energetically to represent the same before all powers and authorities likely in the least to help do them justice. And though of late the defect has been partially remedied by the creation of a Princes Chamber, that body is much

too amorphous and ineffective to be able to render just precisely the service the States are badly in need of. Lack of any clear-cut principles agreed to be invariably applied in settling such matters is another explanation why the States seldom succeed in their attempts to have justice done to them in matters of economic relationship or interests at stake, as between the States and British India. If the States desire seriously to prevent such injustice being done to them and their people in the future, they will first have to remedy this double defect due to the absence of any organisation of their own to consider and represent their case, and the vagueness, or uncertainty of the principles to guide the settlement of such questions.

To understand, however, the actual position in regard to the Customs revenues, a brief retrospect of history will, I think, be not at all out of place at this point. The grievance of the States in this respect has taken an acute form since the War ; as, before that time, the fiscal policy of the Government of India was dominated by the rigorous principles of Free Trade, and so involved no serious financial injustice to the States. The changes made during the War were demanded by the Government of India as a grace for the special emergency of the War ; and, given their history and traditions ; given their past amicable relations and close co-operation with the Government of India, the States obviously could not be so churlish as to stop and think of their own particular interests at a moment when the entire Empire was engaged in a life-and-death struggle. But because they showed this consideration in the hour of the British Empire's gravest need, they ought not,—the States justly feel,—to be prejudiced by the subsequent developments in regard to the fiscal policy affecting the British Indian peoples. They have realised, indeed, that the manipulation of the Customs

Duties has not exclusively, or even predominantly, a financial aspect, for them as well as for the rest of India. They know and believe it to involve the most vital economic interests of the nation in its new struggle for an industrial revival, which no true Indian could obstruct for reasons of his own particular interests being jeopardised. Hence, when the Government of India at last decided to have the Fiscal Policy of the country reviewed and recast, the States' representation, while making a plea for their own particular interests, did not, however, oppose the general revision of the governing principles of Fiscal Policy, with a view to afford better protection to promising Indian industries. In doing so, the States thought, and rightly, that they would not only be serving the best interests of the country as a whole, but earning at the same time an additional claim to the considerateness of the Government of India for not embarrassing them in their hour of need, as well as for seconding their efforts at the intensive economic development of the country in normal times.

The Treaty rights of the Indian States, it may be mentioned here, in this regard, are neither clear, nor uniform. Time will not permit me to sketch even the outlines of all these Treaties made in the course of more than a century; but it is necessary to add that such specific treaties as there are aim at securing the greatest possible freedom of trade between British territories and the Indian States territories. Only a few of the more important Indian States have specific commercial Treaties,—that with the Nizam concluded in 1805 being the most ancient as well as the most typical of the fiscal ideas of the time. The Hyderabad Treaty binds the Indian State to a fixed Customs Duty of its own, leaving the Company's Government free to vary their Customs dues as suited their convenience. The trade facility secured by the Treaty in

favour of the Company extended to all British produce, whether Indian or non-Indian, though the Hyderabad produce was not secured the same treatment in other parts of the British Empire. With the exception of grain exported from the Nizam's territories, all exports therefrom were to be charged a duty. All transit duties were to be mutually abolished in their respective dominions by the contracting parties; while the Nizam was given the right to establish a factory at a convenient British port, though the actual words of the Treaty are not clear if, at this port, the goods imported by the Nizam merchants for the Nizam's dominions are to be free from the British Import Duties. Article V is very significant, and deserves to be quoted *in extenso* :—

> "A duty of five per cent and no more shall be levied at Hyderabad indiscriminately on all articles of merchandise whatever imported into His Highness's dominions from the Company's possessions. No article shall pay duty more than once. The duties payable shall be regulated by a just valuation of the article or commodity on which they shall be charged, and which shall be determined by an invoice authenticated by the seal and signature of the proper officer on each side. Nor shall any arbitrary valuation of any article or commodity be admitted to enhance the amount of the duties payable thereon, and the said duties shall be fixed and immutable except by the mutual consent of the contracting parties."

With Mysore the Instrument of Rendition stipulates perfect freedom for all supplies imported for the use of the British troops stationed in Mysore territory from all duties and taxes, unless otherwise authorised; but the Mysore Maharaja is bound to conform to such advice as the Government of India may give in connection with his finances, revenues, "extension of commerce, encouragement of trade, agriculture and industry,"—which is sufficiently wide and vague to include anything the British

* Cp. Aitchison's *Treaties.*

Government of India might desire to impose on the State. Mysore has wisely chosen to have no Customs Duties of its own, to the no inconsiderable advantage of the trade of its own citizens. With Baroda, there seems to be no specific commercial Treaty; though that State also has abolished all transit duties, and exempted from its own Customs all supplies for British troops imported into Baroda territory. In return, the British Government extends a similar exemption to the stores imported by the Baroda ruler for personal consumption. With Kashmir there is a special Commercial Treaty, made in 1870, whereby transit duties were abolished by the Kashmir Durbar on British Indian trade with Eastern Turkestan passing through the State territory; and in return the British Government has agreed to abolish duties on Kashmir shawls, and to refund Customs duties charged at British ports on goods imported for Kashmir, or for export thence to Turkestan, provided that such goods are declared and sealed for transportation in bond through British India by certain specified routes. A similar indulgence is shown to Travancore under a special convention made in 1865, as also to certain Rajputana States.

On the whole, however, with these exceptions, the present position in regard to the Customs revenue, and particularly as affecting the States, may be summed up roughly as follows :—

(1) All States have had to abolish transit duties in their dominions, to the clear benefit of the British Indian trade, and to a demonstrable and progressive prejudice to their own revenues.

(2) The British Government of India, nevertheless, charges its own Customs Duties, varied from time to time to suit the financial as well as the economic requirements of

British India exclusively, on all goods imported into India from overseas or across land frontiers. In so far as these duties fall on the goods destined for, or consumed in, the Indian States, they amount virtually to transit duties.

(3) Such States, as have their own Customs Duties on goods imported into their territories, levy these as additional burdens on their own people.

(4) Goods imported through British India for the personal use of the Ruling Prince, or for the public use of the State, are free in the case of Baroda in virtue of a special treaty, or as a matter of public courtesy. *Per contra*, all supplies for the use of the British troops and the Residency in the States' territory are, by treaty, exempt from the States' Customs Duties.

(5) Except Kutch, some Kathiawar States, Baroda through the port of Dwarca, and the Malabar States of Travancore and Cochin, the Indian States have no sea-port of their own. The maritime States have either neglected this their natural advantage in the past, so much as to be beyond the power of effective retaliation; or have signed treaties agreeing to charge at their respective ports the same Customs Duties as may come to be charged from time to time at British ports. The recent intensive development of certain Kathiawar ports in the States' territories has directed attention to the matter, arousing the jealousy of British Indian merchants suffering from a loss of trade in consequence. For the non-maritime States, the position is the same, whether they draw their supplies through

British Ports, or through States' ports; for they lose the Customs revenue in either case.

(6) In almost all Indian States, the Customs Duties are charged, both on imports and exports, for revenue reasons. The rates are, therefore, necessarily moderate; and the charge is indiscriminate on all commodities, the export of grains from the States being sometimes totally forbidden.

(7) As, by other treaties, the States are forbidden to have any relations, except through the British Government, with other States, they are powerless to make effective arrangements for a policy of retaliation by forming their own Customs Union, even if geographic conditions could permit them to establish through intercourse in their allied territories. The same applies to any compact for industrial development purposes. There is, as a matter of fact, no solid block of States' territory at all, comparable in wealth or population to British India.

(8) The principle of a Zollverein, adopted in connection with certain maritime states, is shorn of much of its benefit to the States by the provision, reservation, or implication, whereby the States are allowed this privilege so long as their ports are not effective rivals of British Indian ports.

(9) The British Indian Fiscal policy, particularly since the advent of the Railways, and due largely to the policy of railway rate-making in vogue hitherto, has resulted in concentrating an overwhelming proportion of the Foreign Trade of India at two or three major ports only. These have been developed regardless of cost, and are administered by an expensive machinery.

Their dues have, therefore, to be substantially high ; and their sensitiveness to competition is high in proportion. The root vice of our modern commercial civilisation prevents the administrators of these ports from perceiving the nation's advantage by having as many outlets for the country's commerce as possible, rather than concentrating the bulk of that commerce at one or two centres. And hence their somewhat acrimonious and undiplomatic opposition to the States' efforts at local port development.

(10) The basic ideas now governing the entire policy in regard to the Customs Duties in British India contain serious grounds for uneasiness to the States. We must examine these a little more fully.

As already remarked, the Indian Customs Tariff was, from the earliest times, a purely revenue tariff. As, after the Transfer of the Company's Government to the British Crown, the reconstruction of the finances of India accepted the then prevalent ideal of as great a freedom of trade as could possibly be attained, the Customs tariff came to be on a very small number of articles, at very low rates of duties. The Indian States, their Rulers and Ministers, were in those days occupied by problems wholly different from the economic development of their territories, and the part played therein by the manipulation of the Customs Duties. Echoes of the controversy begun between the people of India and the Government of India, and centring round the Cotton Excise Duty imposed to counteract the indirect protection alleged to be afforded by the Indian Import Duties on Cotton manufactures from Britain, must no doubt

have found their way to the ears of the Rulers of the Indian States, especially in those cases where the States themselves were invited to co-operate with the British Indian Government by allowing this inequitous duty to be imposed on cotton goods made in their territories. But it is open to doubt if the States or their Rulers realised the full significance of this measure in the scheme of India's national economy. Certainly, at another milestone in the economic or Fiscal history of India, made in the course of the European War, the States again forbore to urge their viewpoint before the Indian Government, in regard to the manipulation of the Customs Duties. And the same policy was in essence followed at the next turning point, when the Indian Fiscal Commission recommended a radical change in the Customs policy, being based on affording a "discriminating protection" to promising Indian industries. This time the States did, no doubt, present a Memorandum, the burden of which was not against the Government of India recasting their Customs policy, so as to afford greater protection to likely industries in India. The main contention it advanced was that the States should be admitted to a fair share of the financial as well as economic benefits that might possibly be derived from such a change in policy. The Fiscal Commission as well as the Government of India have, so far, kept the States' case in abeyance, if not shelved it altogether; though the States cannot, naturally, overlook the injury wrought to their people, their material development, and their finances, by the new turn taken by the Indian Fiscal policy. Sir Sivaswamy Iyer may be impressed with the States' silence or acquiescence in these frequent changes in the Indian Customs policy; and you may, if you like, regard with him the right of the Indian Government to the entire proceeds of the present Customs as being founded on Nature's gift of the peculiar geographical position that has

denied the Indian States any direct outlet to the sea. In point of fact, however, no thoughtful statesman can afford to overlook the clear fact of our history, that the States' acquiescence in the changes of fiscal policy, made by the Government of India in the last seventy years, was achieved, either because the total burden imposed by way of the Customs Duties by the then accepted principles of policy in the Government of India was too insignificant to demand an effective protest ; or because they did not consider the moment quite happy to make a representation at a time of the utmost danger to the Empire as a whole. No fair-minded critic of the States can penalise them for this their forbearance; and much less injure them for their having not obstructed the new orientation in the Fiscal policy of India made some five years ago. And as for Nature's gift of a geographic advantage being the explanation and justification of the Government of India's claim to the exclusive enjoyment of the country's Customs Revenues, we are all familiar enough with the making of the modern British Empire in India to realise that man has given a very distinct push to Nature in this affair. The entire argument of Sir Sivaswamy Iyer in this behalf reads to me like a highly elaborate special pleader, despite the eminent authority and analogy on International Law quoted in support of it. That the claim of the States for a share in the Indian Customs revenue might sensibly endanger the hard-won financial equilibrium of the Indian Government is no argument, in political ethics, to deny this right to the States, if on other grounds their claim is unchallengeable. And the fact that: international usage and courtesy have all along allowed free transit to the goods of the inland States over the territory of neighbouring States; that several States are in India also allowed this privilege by special convention ; that the trade of Nepal and of Afghanistan enjoys the same privilege

in India as that of Switzerland over the French or Italian, or German and Austrian territories; that the willing co-operation of the States hitherto in all such matters as minister to the economic development of the nation ought to win them a consideration in this regard, even if there were no other reasons for that attitude,--all these po[illegible] irresistibly, in my opinion, to the necessity of a radical reconsideration of this question.

It is, indeed, evident that for a sound federation to be built up in this country, the Customs central will, as a matter of course, be assigned to the Duties federal government. Financial as well as the broader economic considerations unmistakably point that way. It is, however, probable, in my opinion, that the Customs revenue of the federa[illegible] Indian Government will continue to have a productive aspect, in spite of any protectionist turn that might be given to it. On those assumptions, the refund,—or compensation,—demanded in one way or another by the component parts of the federation,—especially the States,—would become impossible to deny. I would not, of course, be understood to say that a clear division of proceeds will necessarily have to be made between the States and the Government of India in order to solve the present problem. The compensation or refund may take any shape, not necessarily a monetary return. But, provided those who are entrusted with the financial reconstruction of India realise that the States are, under existing conditions, losers, because of the burden borne by their citizens without any corresponding benefit to them from this revenue of the Government of India; because of their own direct burdens as consumers; and because they do not get to participate in the benefits of the protectionist policy in regard to the industrial development in their own territories,—they will surely be able to devise means, whereby the just

claims and representations of the States could be fully attended to in practice. Speaking for myself, I am, indeed, unable to agree to the suggestion that the States might be allowed the benefit of the Barcelona Convention and the Statute of the Freedom of Tranist made in 1921, under Article 23 of the League of Nations Covenant, which provides :—

> "The measures taken by the contracting states for regulating and forwarding traffic across their territory shall facilitate free transit by rail or waterway."*

The very next article of the same Statute provides that traffic in transit shall not be subject to any "special dues" in respect of transit, including entry and exit. The authority I have referred to founds the strongest plea on this term " Spec Dues," arguing therefrom that the special dues being forbidden do not necessarily forbid the usual Customs Duties, in the absence of any specific convention to the contrary. The Indian States have, indeed, no such special convention with the Government of India ; but their own ready consent to abolish their local transit duties, to the immense loss of their own revenues, must permit their advocate to infer, by implication, the fact of such a tacit convention. Current practice among friendly states, moreover, amply supports this interpretation of the clause, and not the special pleader which would exclude the Indian States from the benefit of the spirit of such a provision. But, in spite of all this, the letter of the Barcelona convention need not be applied in India, if the considerations so far urged are duly realised.

If the principle of a refund, compensation, or share in the Customs revenue of the Government of India is conceded, the exact share of each State, as well as the mode of calculating, and the

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* Quoted in Sivaswamy Iyer, Op. Cit. p. 239.

manner of granting it, may be left over as a matter of detail, to be settled by subsequent calculation, negotiation, and convention. The States must, I think, relinquish, as a matter of course, their own existing and additional customs dues, levied on a uniform rate by most States, without any well-considered scheme of state development,—as a condition precedent to this principle of compensation being conceded. Their doing so would add to the purchasing power of their own subjects, and so add to the total volume of the foreign trade of India, which must, in its turn, swell the Customs revenue of the country. They must also have a voice in determining the general principles, from time to time, regulating the details of the customs schedule; though it is open to argument that in such a scheme they are likely to be in a permanent minority. They must also participate, as equal members of a federation, in selecting the exact industries to be protected, as also in distributing evenly the benefit of such a protection. And, last but not the least, their finances must be benefited, whether by increase in their revenues or by equivalent saving in present expenditure, in proportion to their just claim in the collective customs revenue. The money value of the claim may be, on the basis of population, on the assumption of 45 crores of aggregate import duties revenue, Rs. 10 crores; on the basis of their inland trade, the calculation would be more difficult; and that on the basis of the actual consumption of the taxed articles in the States would be still more difficult. But round about the figure given above, the States would have to be compensated or benefited, if a just and equal federation is to be formed in India.

SALT.

The grievances of the States in respect of the Salt Tax are not a whit less important than those in relation to the Customs Duties, except for the

amount at stake. The Customs Duties have, however, assumed their present importance only in the last ten years ; while the complaints in connection with the Salt Duty are at least fifty years old. The British Government of India have been levying a Salt Duty since 1760, and have claimed it to be a heritage from the previous rulers of the country. How precisely those preceding Governments levied this tax is not quite known ; but the consolidation of British rule has witnessed, since 1877, a series of Treaties with the chief salt producing States in the country, in order to permit a uniform rate of taxation throughout the Empire, whether British territory or Indian States.

The Salt Duty and the Opium Revenues have points of some similarity *inter se*, but far more differences. While the Salt Tax is a burden falling wholly on Indian shoulders, the Opium Revenue, such as it was, was derived from non-Indians. The Government of India derived both these revenues from their own, as well as the States' territories. But, while in the case of the Opium Revenue, falling entirely on non-Indian shoulders, the Government of India were pressed again and again by their masters in Britain throughout the Nineteenth Century to sacrifice their profit from this source, till at last in sheer desperation they had to agree, in the case of the Salt Tax, falling as wholly on Indian shoulders, the Government of India have held,—and they have been supported in so holding by their "Home Authorities,"—that ' on all grounds of general principles, Salt is a perfectly legitimate subject of taxation."*

Now that the Opium Revenue is dwindling by international convention to the point of disappearance, it is less than ever likely that the Salt Duty will cease to be an integral part of the Indian

* Cp. Strachey, *Finances and Public Works of India*, p. 222.

Public Finance, in spite of its unfair incidence, and inequitous nature.

The systematisation of the Salt revenue, and unification of the duty, were achieved, as already observed, by a series of Treaties with those Indian States which were the principal sources of salt production. The Treaties generally provide for a sole monopoly of salt manufacture in the area concerned being granted to the British Government, in consideration of a compensation paid to the States. The Treaties, however, are not uniform, nor the compensation calculated on an identical basis. They were also made the occasion, in some cases, to extract pledges from the States to prevent the export, not only of Salt, but of other stated articles, —mainly intoxicants like *Ganja*. As the State were also made to sacrifice their revenue from Transit Duties by the same series of Treaties, the compensation was calculated on the basis of the loss to the States' revenue from this sacrifice, as also on account of the salt manufacture till then carried on in the States. As, at the time these Treaties were made, these regions were devoid of any transport facilities worth the name ; and as to-day that defect is in considerable measure remedied, the States now feel that the compensation awarded to them under the Treaties is utterly inadequate, being given on obsolete lines. The benefit to the British Indian economy, from the growth of unrestricted inland trade, was perfectly understood by the highest financial authorities in the Government of India, both actually at the moment, and prospectively with improved communi cations in the future. They were, therefore, confident of making up such loss in their revenues as resulted from the simplification of the Salt Duties, very soon from other sources ; but no such consideration was borne in mind when fixing the cash compensation to be paid to the States con-

cerned. At the prevailing rate of Salt Duty, the Government of India derive an aggregate revenue of a little below 8 crores per annum from all over India, or 4 annas per head of population. As Salt is a necessity of life, there can be no very great difference in consumption as between the richer and the poorer areas. Hence the States are justified in calculating that their subjects pay nearly 1.75 crores of this revenue to the Government of India. Against this, the total compensation allowed amounts to only 36 lakhs; though of course the Compensation goes only to those States whose Salt sources have been taken over by the British Government of India, while the salt duty is borne by all the people of India alike. A better and a juster contrast would be provided,—could it be accurately calculated,—by the volume of transit trade now passing through these compensated States, on which they lose a considerable revenue, thanks to these Treaties. It would be interesting to ask what rejoinder people like Sir Sivaswamy and other advocates of the Indian Government, who consider the monopoly of the Customs Revenue by that Government to be the outcome of a natural geographical advantage, would make to the States' complaint in respect of the Salt Duty. Is that also due to a natural advantage of the geographical position and initial endowment of British Indian territories? Can it be pleaded as such by the British Government against, (1) either the States whose Salt sources the British Government have acquired for an inadequate compensation; or (2) against those other States, far more numerous and populous, who have no salt sources of their own, and who nevertheless are mulcted every year by the British Government of India for the benefit of the latter's Salt revenue?

Sir John Strachey, the financier of British India most directly concerned in making these arrangements, has observed :—

"As an unavoidable consequence of the new system and one without which the relief of our own subjects would have been impracticable, the people of the Native States in question became generally liable to the payment of the British salt duty; a portion, however, of the population still obtains salt free of that duty, and another pays only half the usual rate.' *

It is not quite clear if Sir John was thinking, when he made this remark, only of the subjects of those particular States with whom his Salt conventions were made ; or of all the Indian States put together The burden of the Salt Duty, it cannot be repeated too ofen, is common to all India ; and so the extenuating circumstances, such as they are, pointed out by Sir John Strachey, in so far as they do not apply to the other Indian States, have no force. To such a contention, however, the answer of Sir John and people of his mode of thinking is very clear. The British Government in India have conferred many advantages by their peaceful settled rule, which are common to all India ; and, in addition, there are specific advantages in respect of particular States in connection with the Salt revenue, which, collectively, must be held to answer pleas like the above. Sir John, however, considered the very fact of the abolition of the Transit Duties in the four main Salt States to be a distinct gain to the subjects of those States, which ought, therefore, to be counted as a set off against the contention that the British Salt duty paid by these people was an unconscionable demand! As a matter of fact, however, the people of these States did *not* benefit by the remission of these Transit Duties, and much less the States. Those who really benefited were the British traders,—Indians or non-Indians,—and the British manufacturers, the market for whose wares was thus handsomely extended and facilitated. Another such specific *quid pro quo* mentioned seriously as a set

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*** Strachey, Op. Cit. p. 226.**

off against the British Government's burdens on the Indian States subjects in respect of the Salt Duty, is described thus :—

> "The removal from April 1, 1878, of the duties formerly levied on all sugar exported across the customs line from our own territories, which fell mainly on the people of the Native States of Rajputana."

Sir John, however, was a Civilian by origin, a Distric Officer by temperament, a Finance Minister by accident of seniority, and by no conceivable claim an economist ! Hence his utter misconception of the nature of the old Sugar Export Duties from British India. British India had then, or has now, no monopoly of sugar production, *vis-a-vis* the Indian States, even of Rajputana ! The latter have their own substitute for sugar, which they would continue to consume, without bearing the burden of the British Sugar Export Duty, incidentally giving a continued employment to their own capital and labour invested in that production. When British India abolished those Export Duties, the people in the States might, perhaps, have got this "foreign sugar' a shade cheaper. The real benefit of that arrangement went to the British Indian (or European) merchant and sugar-producer, whose trade received a fillip by the duty being abolished ; and the real sufferers from the arrangement were the producing interests of sugar in the States.

Among the indirect benefits to set off against the salt burdens on the people of the States, Sir John gives pride of place to the improved transport arrangements constructed by the Indian Government at their own cost and risk in these regions, opening them up, and so facilitating their development. How far railway construction benefits the *people* of a region through which the road passes, immediately and ultimately ; how far railways in India have been constructed exclusively on com-

mercial considerations; how far there ever was any "risk" involved to those who began railway construction in this country;—these are questions with which we are not primarily concerned here. But to the point made in this regard by Sir John Strachey, the rejoinder is unavoidable that: whatever may have been the case at the time he made the remark, (1882), the States have since not been indifferent to the advantages of transport facilities, and have contributed their mite to this development; so that neither the cost nor the risk have been entirely those of the Government of India. As a matter of fact, therefore, and quite apart from the statement of opinion involved therein, the plea put forward by Sir John or his followers is inadmissible.

For the most substantial, however, of these indirect advantages, in the opinion of British Indian financiers, let Sir John speak for himself, and his line of apostolic successors:—

> "It has been generally felt that the Native States throughout India ought to make much larger contributions towards the general expenses of the Empire, than we now receive from them. For the maintenance throughout India of peace and tranquillity, they pay, for the most part, almost nothing; and these inestimable benefits are mainly provided for them at the cost of our own subjects. In many cases, however, a partial remedy has been supplied by the operation of our Salt Duties. Thus the State of the Nizam, all the Native States of the Punjab, and others in other parts of India, derive their supplies of salt, wholly or in part, from sources where the British duty has been levied, and these States thus contribute indirectly towards the revenues of the British Government. * * * * * If the new arrangements should give some direct financial gain to our Treasury, they will in truth cause the partial removal of an injustice, not inflict one."

This is no argument, but a highly elaborate special pleader, evincing, by the mere fact of its being ad-

* (Op. Cit. p. 228-9).

vanced the utter bankruptcy in argument of its author. In putting forward this consideration, Sir John seems to have utterly forgotten the existence of the *Tributes* from the Indian States, which make a direct contribution to the British Treasury specifically in return for the advantage claimed to be conferred by the British Government. And, still more to be noted, is the transfer, by these very States, of vast blocks of territory definitely for the maintenance of an adequate force for the defence of these States, and the preservation of general peace in the country. The revenues from these regions to-day aggregate crores upon crores. Even at the time they were first made over to the British Government, the income therefrom was more than equal to the share that could justly be charged to the States of the cost of national defence and the maintenance of peace within the country. The States, on their side, might well urge that the loss of employment to capital and labour in their territories, once engaged in salt production, is utterly uncompensated by these Salt Treaties, and has been progressively injurious to the States' exchequer and to the peoples gnerally, not to mention the fact that the Salt production and con sumption having increased, the compensation in respect of this should also be increased.

The case of the Salt Duty is analogous to that of the Customs Revenue, and must be treated accordingly. In a proper federation of India, the Central Government would have to be given sole charge of this source. But, to the States producing salt at least, a compensation will have to be made for their sacrifice in thus surrendering a source of revenue arising from their natural advantage. However calculated, the compensation must be capable of being revised every ten years when a census is taken, though it need not necessarily be a cash payment.

EXCISE.

The Excise Revenue, drived mainly from the consumption of intoxicants, is, in India, contrary to the precedent of other federations, a purely provincial item of income. The Indian Taxation Enquiry Committee would, as already noticed, suggest a redistribution, in part at least, which would make that revenue follow more effectively the control of the administrative system in that behalf, as well as be in greater conformity with the accepted principles of *Federal Finance.* But no action has yet been taken on their recommendations. The revenue of the several British Provinces from this source amounts to close on Rs. 20 crores, equal to the yield from the Taxes on income. Considerable, however, as this amount is, the problem of the Excise Revenue is very much complicated by the admixture of the social element. It is open to question if the authorities that be are fully alive to the demands of this social problem, especially when the same is in such marked conflict with the revenue needs of Government. Indian opinion, however, and the better elements in the official hierarchy, seem to be agreed that the revenue aspect should be entirely subordinated to the requirements of social reform, even to the limit of absolute prohibition. The Taxation Committee could not persuade themselves that the time was ripe for India to adopt a policy of absolute pro hibition ; but the growing volume of enlightened public sentiment in the country is likely to force the hands of Government as least so far as to make this item a steadily diminishing source of public income.

In the States, however, the problem is sti mainly of revenue ; though that statement should not be construed to mean that the better minds among the Indian States Ministers are not alive to the mischief of this revenue. The States have, in

fact, always co-operated whole-heartedly with the British Government of India in every project of nation-building, even when the process involved direct personal loss to themselves. The instance of the Salt Duties has already been mentioned, as also that in connection with the Transit Duties, as exemplifying the States' readiness to co-operate even at the risk of some loss to themselves. We might add here the instance of the Countervailing Cotton Excise Duty, of inequitous memory, in imposing which on the cotton products within their own territories, the States have afforded the most costly, and even the most dangerous, proof of their untiring and unquestioning readiness to second all efforts of the Government of India to achieve a given point in administrative reform. It is more than doubtful if their own intelligence and reason ing,—not to say their own immediate interests,— had convinced them in such cases of the wisdom of the course advised by the British Indian Government. Given these precedents, it is impossible to question, that, if and when the Indian peoples are finally determined to abolish the traffic in intoxicants which plays such a havoc with their human factor, the States would be lacking in active sympathy and support, no matter what the cost to their Exchequer may be. To-day, however, when a de finite decision of such a radical character is still wanting in the British Indian Government ; when the latter are unable to devise even for themselves sufficient alternative sources of revenue, to make good a consequential deficit, the States can hardly be blamed for considering their own side of the Excise problem financially.

The grievances, however, of the States, in connection with the Excise Revenue, are rather matters of administrative detail, than those involving any fundamental principles of Federal Finance or organisation. But, such as they are, these petty

grievances militate against the engendering of that spirit of full sympathy and mutual understanding, which is indispensable for the growth of sound federalism. As already remarked, the fact that the proceeds from the Excise taxation go to the several local governments in India obviate the basic injustice to them, created by the monopolisation of that other indirect head of taxation : Customs by the Central Government. The States, like the Provinces, have their own Excise systems, and enjoy their own proceeds from the same. One Government does not tax, in this instance, the subjects of another ; and so the problem created by the Salt or the Customs revenue is absent in this case. In only one case of any importance, perhaps, the difficulty in this behalf involves a point of principle. *Charas* imported from Yarkand is taxed at Hoshiarpur by the British Government exclusively, though the consumers of this taxed material are as much in the Indian States, as they are in British India. Imported spirits also follow the same model, and give rise to the same injustice. The last-mentioned item causes particular uneasiness to the States' financier, not only because of the double taxation the foreign spirits imported into British India have to bear when consumed in inland States ; but more particularly because the Railway Station Refreshment Rooms, where they sell such spirits, inflict an incalculable injury and injustice on the States con cerned. Railway Stations are now-a-days almost in every State ; and every such place,—at least on the line not owned and worked by the State itself, —is recognised by Treaty to be British territory. The Station Refreshment Room spirits, therefore, are charged with only the British Customs Duty ; while the liquor-shop next-door, but in the territory of the State, has to pay first the British Customs Duty, and next the Excise Duty of the State itself. Competition is thus very hard and unequal for the local liquor-shops in the State area. The hardship

is doubled, when one remembers that, more often than not, the caterers for the railway travelling public are in close alliance with the Railway companies or administrations concerned ; that they, therefore, get advantageous rates for the transport of their liquor consignments, in comparison with the ordinary vendor in the state territory immediately outside the Railway compound ; and that, from the mere juxtaposition, and due to this hardship in taxation, a heavy premium is placed on the smuggler taking a bottle or two each time across the dividing line with perfect immunity. This is, therefore, both an administrative, as well as a matter of root principle ; and the sooner it is attended to by the parties concerned, the better it would be for the sentiment for federation.

Of the minor matters of administrative minutiœ, the most considerable is in connection with the fixed cash compensation paid to certain smaller States by the British Government, in consideration of the former having surrendered their Excise administration to the latter. The amount payable by way of Compensation is calculated at rates prevailing at the time the arrangement was arrived at. As the rates have since been very considerably increased by the British Governments concerned for their own benefit, the compensation comes to be small out of all proportions. The British Government replies, when representations on this account have been made to it, that by the very nature of the agreements under which the Compensation is paid, the amount will go on being paid, even if the British revenues from this source should disappear altogether owing to an adoption of a policy of absolute Prohibition. But to the States concerned, the argument sounds very hollow, as they cannot believe that absolute Prohibition is an imminent proposition in British India.

As regards the actual rates charged, the States adjoining the several Provinces feel that their side

of the matter is never considered by the Provincial Governments, whenever the latter alter and increase the rates for their own reasons. This lends a special stimulus to the activities of the smuggler, or illicit producer; but the representations of the States concerned are seldom attended to as they might be by the Provincial Government involved. On the other hand, if any State should choose, for its own reasons, to raise *its* excise duties, the adjoining British Province will not fail to make the strongest remonstrance that one Government could possibly address to another. And, of course, the State concerned has to listen, no matter how much it might in its own private council resent the remonstrance. The grievance threatens to be cumulative; and if it is to be removed,—as it must be,—some machinery must be devised for previous consultation and agreement, or adjustment, before action is taken on either side of the frontier. At such joint conferences of Excise and Finance Ministers in adjoining administrations, all minor points of administrative detail,—such as the code of regulations to prevent smuggling and illicit production, or the opening of liquor shops within stated areas, or the limits of the "shopless" zone on either side of the boundary,—might be discussed and amicably settled, subject, of course, to the guiding principle of policy in this behalf, as laid down by the national Legislature for the benefit of the country at large, and in framing which the representatives of the different Governments,—States' as well as provincial,—would have their due share.

OPIUM.

The grievance of some of the States in regard to the Opium revenue and general policy of the Government of India is more serious than any other
Government of India is more serious than any other
single item hitherto considered. For more than a

generation, however, the problem has ceased to have the vital importance, which the very mention of the topic used to invoke formerly; and if the enlightened opinion of the civilised world, as reflected in the recent international conventions on the manufacture and sale of Opium is allowed to have its course, we may live to see the entire revenue from this item disappear altogether within a period of at most ten years from now. The problem now resulting is rather one in connection with what may be called "Excise Opium," and the aftermath of the international conventions, which has compelled the Opium producing States of Malwa to lock up very considerable quantities of capital in their now steadily accumulating and unsaleable Opium stocks. This is not the place for me to inflict upon you an outline of the history of Opium Revenue and policy of the Government of India. Those of you who are interested in the matter may be referred to that other work on *The Sixty Years of India Finance*, from which I have borrowed frequently and copiously for these Lectures. At the present time the States concerned are very few in number; but those have a grievance of very long standing, and even now not inconsiderable. Let us, therefore, cast a hurried glance at its origin and progress to date.

From the earliest days of British supremacy, the Government of India have endeavoured to obtain a practical monopoly of the manufacture and sale of Opium. Like Salt, however, Opium is produced in a number of districts, some of them in the British provinces of Bengal and Bihar, others in the Indian States of Gwalior, Indore, Bhopal, Dhar and Dewas. The latter,—the so-called Malwa Opium, is superior in quality, yielding 90% to 95% of fine opium per chest, as against 75% to 80% available in the Bengal or Bihar Opium chest. Negotiations were started in the twenties of the last century with these States to secure a

monopoly; and in 1826, Indore, Dhar and Dewas agreed to let the British Government have an exclusive right of purchasing all the Opium grown in their territories, at a fixed price, and subject to the condition that the cultivation of poppy in these States was in future to be limited to a stated area. Other States, with Gwalior leading, declined to fall in with these arrangements. Lord William Bentinck recorded his opinion :—

> "We are bound, by paramount considerations of justice and good faith, to withdraw altogether from the interference with the growth and transit of Opium throughout India."

The monopoly secured in Indore and other States was abandoned in 1829, and the system of a heavy "Pass Duty" on Malwa Opium passing into British territory was substituted and developed in stead. The "Pass Duty" was calculated so as to make up for the difference in quality, and therefore in price, between the Bengal and the Malwa opium; and was varied from time to time throughout the Nineteenth Century to meet the requirements of revenue and policy of the British Indian Government. Starting at Rs. Rs. 175 per chest, it stands to-day at Rs. 1,200/- per chest, and has operated along its history as a Transit Duty, pure and simple! The Anglo-Indian financiers were unremitting in their condemnation of the Transit Duty in principle, and they managed to obtain a complete abolition of those duties from the States in the latter half of the Nineteenth Century: but against their own Pass Duty on Malwa Opium,—Transit Duty as it was without question—they would not hear anything from the States affected. At last a Royal Commission was appointed in 1893 to advise the Government of India as to :—

> **"On what terms, if any, the existing arrangement for the transit of this Opium through British territory can, with justice, be terminated."**

And the Commission advised, in 1895 :—[1]

> "We are of opinion that by paramount considerations of fair dealing and good faith, ... the Government of India is precluded from withdrawing the right of transit, except with the free consent of the protected States. It is clear that any agreement that might be arrived at could only be arranged on payment of large pecuniary compensation. . . . . . . We are aware that it has been suggested that the present arrangement for the transit of Malwa opium to the sea might be ended, without direct interference on the part of the Government of India, by an enhancement of the Pass Duty up to a point that would be found prohibitive ; but we consider it sufficient to say that the considerations on which our general conclusion is founded would, in our opinion, be equally valid against any such indirect method of extinguishing the export trade." *

In spite, however, of this considered opinion of a Royal Commission, both the eventualities envisaged and condemned by that body came to pass, within ten years of the Report. The " Free consent of the States concerned," without which the Commission would not suffer the Malwa Opium trade to be ended, was never obtained, though the trade has in fact been destroyed by the *ex parte* engagements of the Government of India with the principal consumer of Indian opium. And the notion of a cash compensation to the States affected has never been entertained, though the Treaties which finally undermined the Indian Opium Revenue were concluded exclusively by the Government of India, and yet affected materially the financial interests of the States. I have already touched upon the contrast between Salt and Opium, each as a source of public revenue in India; and the contrast appears to be all the heavier to the Indian States, which have not sufficient alternatives to make up for adventitious deficits in their Budgets, brought about by such arrangements as those of the Indian Government with China. The States

[1] Cp. Para. 116 of the Brassey Report.

concerned did, indeed, represent to the Indian Government that the Treaty in question was one made between the British Imperial and the Chinese Governments, to which the consent of the States was not previously obtained ; and that, accordingly, they could not be bound by the terms of such an engagement. But the Government of India's only reply was to make a slightly more liberal allocation for the Opium to be exported, in 1911-13. As the question of principle involved was not answered at all, the States concerned next demanded a *pro rata* distribution of the allotment for export from the exporting areas, as also a proportionate apportionment of future production between the productive districts ; the abolition of the Transit Duty; and an equal share in the export trade with the non-China markets still available for Indian Opium. The Indian Government turned a deaf ear to practically all these demands, adding, in reference to the non-China markets, insult to injury by the observation, that if the exporters from the Indian States had not already secured an equal footing in the non-China markets, they had themselves to thank for their plight. The only compensation the States got was the assurance that the requirements of local consumption will be met from Malwa Opium ; that a priority would be established for purposes of export ; and that when the Pass Duty reached the maximum, the States would be made to share with the Government of India the profits of the increased Pass Duty, as well as in the auction proceeds of the right to export. These were hardly worth the name of concessions ; and the Government of India finally closed all discussion on the subject in 1915, by ruling categorically that : "It was impracticable to offer facilities for the sale of Malwa opium in foreign markets."

The position, however, became worse progressively by this decision. The States, hampered

in the extra-China markets, and hoping against hope for some change in mentality, went on accumulating their Opium stocks. The more discerning among them have since desired to utilise these for purposes of drug manufacture, if ordinary export is not feasible. The Gwalior Durbar, for example, after consulting and being assured by experts as to the possibility of extracting marketable morphine from their opium stocks, approached the Government of India for permission to open a necessary factory for the purpose. For two years the Government of India slept over this simple request, which, under the existing Treaties, the Gwalior Durbar were not obliged to make. Tired of the silence, the Durbar next offered to sell all the morphia made at such a factory to the Indian Government, at cost price plus a profit 12½% ; but the Government of India simply declined to agree to any such proposition.

The present position, then, in respect of Opium may be summarised thus: The Government of India have bound themselves to bring the cultivation of opium to an end by 1937, when it is hoped opium smoking will have been abolished, opium consumption in other forms greatly reduced, and opium products for medicinal use under strict regulation. Though strictly not bound by treaties to which they have been no party, the Indian States are nevertheless made to suffer along with British India financially in this behalf ; and, in consequence, they have accumulated, in twenty years of unavailing protests and ineffectual proposals vast stocks of opium, which press particularly heavily on the small States, who have never had any share in the compensation that has sometimes been allowed. By way of remedy, the States ask: (1) for the abolition of the Pass Duty, which offends alike against economic law and political equity ; (2) an equal share in the domestic market with the Bengal Opium ; (3) freedom of

export to the non-China markets upto at least their fair share of that trade, if, that is, the Government of India would not themselves buy up and dispose of the accumulated stocks. The latest request for permission to establish factories in the States to manufacture alkaloids deserves even more sympathetic treatment than it has received so far, especially as it is aimed at turning an actual loss into a profit.

Profits from public Enterprise or State Property.

Governments in India have a variety of such profits, and a multitude of public enterprises Those, however, which interest us here,—*Viz.* such as give rise to quiestions of an inter-statal nature,—are concerned with the Railways, the Irrigation Works, and the Post Office, including Telegraphs and Telephones. Other cases,—like the Mint, the Currency system, or a State Bank,—are either worked on principles distinguishable from those governing revenues from collective state enterprise; or are yet not in proper working order. I shall not, indeed, utterly overlook even the latter category; but, for the moment, I am concerned with the former, particularly as in their connection grave questions of interstatal right have already emerged.

A.—The Railways.

Looking at this magnificent asset of the State in India, from the standpoint exclusively of Federal Finance, it must be premised at the outset, that the Rail-road may be regarded as both a local as well as a central concern. In so far as it is fixed in irremovable property in the permanent way, stations, sheds &c. and the land on which all these stand, it is distinctly a local,—provincial or state,—affair; as also, perhaps, in regard to the traffic coming to the railroad, as originating from the people or

industry of particular areas. It is in recognition of these peculiarities of the enterprise, that in some federations, notably the Australian Commonwealth, the railroads are both a federal as well as a State concern. In India, also, there are railways which are purely city lines; others which are district enterprises ; and still others which are exclusively state concerns of the individual Indian States ; while the main lines of traffic going through several States and provinces are central concerns exclusively. The central federal government must necessarily be interested in railways, for purposes of general co-ordination ; for laying down the governing principles of policy determining the rates and fares, as well as the alignment of particular lines ; and for the policy of general administration, with special reference to the contribution of railways in the economic development of the country as a whole. The multiplicy of purposes that railways serve, and the multiplicity of reasons that enter into the original undertaking of the enterprise, are seldom recognised sufficiently by the man-in-the-street ; and so the number of points at which railway administration might give rise to inter-statal conflict in a federal organisation is not fully appreciated. The medley of social, political and economic motives, entering into railway construction and administration, is fully illustrated by the case of India, though stress is laid most commonly on the " commercial " aspect of the asset as it now stands. The fact, however, that there are and have been other considerations besides that of commercial gain from the railway enterprise justifies the central control of all questions of general policy relating to this matter, with a view to secure greater co-ordination, and better utilisation.

The interest of the Indian States, however, arises on grounds peculiar to this country in a large measure. Unlike the British provinces, they have

substantial interest in the working and the success of individual railways, whether those for which they have themselves advanced capital or stood guarantee; or others in which they are interested in common with the Government of India, because of the line's passage through their jurisdiction. Under specific Treaties made with individual states for the purpose, the States have provided the land, free of cost, for the construction of the permanent way and the necessary appurtenances to the railroad passing through their territory, though owned and worked by the Government of India, or by Companies working on the latter's guarantee. They have also agreed to sacrifice their Transit Duties on goods passing over such a line through their territory; and, by the same treaties, they have surrendered a degree of jurisdiction over such area as the railway property occupies in their states, which give rise to a wholly independent set of political and administrative complications. Moreover they provide no inconsiderable proportion of the goods and passenger traffic on these lines passing through their territories, and so help to swell the gross receipts,—and even the net profits,—of this enterprise. On their own exclusive lines, also, they are bound by treaties to follow a predetermined policy in alignment, construction, and working, so as not to make too great a contrast or difference from similar considerations on the common Indian lines. On purely economic or commercial grounds, then, the States are interested in the smooth and profitable working of the railways, to which the provinces of British India can show little parallel.

The non-commercial aspect of the railway enterprise interests the Indian States, severally and collectively, no less; though I do not propose to devote disproportionate space to that aspect in these Lectures. The progress of events in the last

two generations may have now obscured the original motives for the construction of the main arteries of communication between the different parts of the British Empire in India. But that is no reason why the intervening States should overlook even to-day the force of those considerations, in so far as their immediate interests are concerned. The Commercial aspect is now-a-days the most commonly stressed consideration ; and the States are no less concerned in that than British India. But the States also remember that, originally, the possibility of commercial gain from the main lines of communication was remote ; that the British Government would have had to construct these for their own reasons of state, to link up their distant seats of power with one another ; that the States that stood on the line of march from north to south, and east to west, had only to wait and watch for railways,—and the consequent opening up of the country,—to come to them, at the cost, at most, of mere acquiescence, or some sacrifice of jurisdictional authority on the line and its appurtences proper situated in the State territory, without a pie of the State money having to be invested. They have, however, taken a far more active part in the enterprise, made a considerable investment of capital,—and all that not entirely for their own immediate interests invariably.

This is not the place for me to inflict upon you an outline of railroad economics ; nor can I wait to consider even a sketch of the Treaties with the different States in regard to the Railways. The following summary of the States' case will, I trust, serve to give you a general idea of the nature and variety of the problems of Federal Finance that confront financial statesmanship in India in the near future :—

(1) The several Treaties, though running on similar lines, nevertheless embody considerable differences of

detail *inter se*. All provided for a grant of land, sacrifice of Transit Duties of the State, and concession in respect of jurisdiction on the railway line passing through the State. The exact nature of the jurisdiction conceded, read in conjunction with the saving clauses of the particular treaties, varies; as also the terms and conditions on which the return on the capital invested by the States in any particular line or the section of a line passing through their dominion. The typical clauses in two or three important treaties, illustrating this variation, are given in the foot—note.* The terms and conditions, moreover, on subsidiary or feeder lines to the main lines, constructed by or in the State territory exclusively, also differ, not entirely because of differences in commercial possibilities of particular areas; but also because of the differences in the bargaining power of the several states.

Translation of a Yad from His Highness the Gaikwar to the

* * * * *

Resident at Baroda, No. 460, *dated* 14*th May*, 1856.

We shall cede the land required for the railway, and the full sovereignty of this land will rest exclusively with the Government of India for railway purposes.

* * * * *

Taking this into consideration we write that this business (railway) should cause no loss to our revenue in the customs, etc., as stated in our Yad of 29th February, No. 232, and we beg to receive a reply to this effect.

* * * * *

Agreement appertaining to the Cession of Criminal Jurisdiction over the Bhavanagar Gondal Railway Line,—1870.

I hereby cede, on behalf of the Baroda State, to the Government of India, all criminal jurisdiction possessed by the Baroda State in the lands of the Amreli Division, which have been permanently assigned and made over by that state for the Kathiawar State Railway, this cession of the Criminal jurisdiction, aforesaid being exercised by the Government of India being restored to the Baroda State when the lands are no longer needed for the Railway.

(2) In the total receipts from the Indian Railways.

Memorandum of terms agreed upon between the British Government and Maharaja Holkar, 1864.

CONCESSIONS MADE BY HOLKAR.

1. Holkar cedes free of any charge all lands required, specially for the Railway, its work, and stations, provided that no lands within Railway limits are taken up by any traders or rent-payers for the purpose of building shops and carrying on trade to the injury of the interests of the Durbar, by the withholding payments of taxes by such parties on the ground of their residing within those limits. And provided also that all buildings, such as godowns, dharmsalas, etc. erected outside the Railway limits shall be entered under Durbar jurisdiction.

2. Full Civil and Criminal Jurisdiction over the lands required for the Railway, its works and bridges, rests entirely with the British Government.

3. Holkar remits all transit duty on the through traffic of the Railway.

Dated the 10*th January* 1866

CONCESSIONS MADE BY BRITISH GOVERNMENT.

1. The British Government agree to give up to Holkar all Durbar offenders, who, having taken refuge within Railway limits, may be found within such limits; but if such persons shall have passed on and escaped into British territory, their surrender must depend on the circumstances of the case, and the pleasure of the British Government.

2. Government will not hold the Durbar responsible for offences committed within Railway limits, unless those offences are traced to subjects of the Durbar.

3. Still retaining the right to exercise its discretion in particular cases, Government as a general rule will not object to deliver to Holkar for punishment Durbar subjects who may have been convicted and sentenced by Government officers for offences committed within Railway limits.

Agreement respecting a loan of one crore of rupees (a million sterling) offered by His Highness Maharaja Tookojee Rao Holkar, G.C.S.I., and accepted by the Government of India, for the purpose of constructing a Railway from the Great Indian Peninsula Railway to Indore, 1870.

1. The Government of India engages to make a railway from some point on the Great India Peninsula Railway to Indore, with all convenient speed, and to supply all funds necessary for its construction and equipment.

the Indian States do not get the share they are by population, traffic, or even mileage entitled to claim. Taking the gross receipts of all the Railways in India at Rs. 110 crores, the States feel that they and their people contribute one

2. The line to be called the Holkar State Railway.

3. The whole of the arrangements as to construction and equipment, as well as management after the line is open, to be exclusively in the hands of the Government of India.

4. The loan to be for 101 years, not transferable, to stand in the name of Maharajah Holkar of Indore, his heirs and successors.

5. The Government of India guarantee to Holkar, his heirs and successors, interest on the above at the rate of 4½% per annum payable half-yearly at Indore, with effect from date of loan payments in Bombay.

6. The Government of India further undertakens to pay to Holkar, his heirs and successors, a sum equal to half the net profits (in excess of 4½ per cent. on the capital) on one million sterling, or any smaller sum, should the Railway cost less, from the earnings of the line between Indore and the Great Indian Peninsula Railway, for which a separate capital account and revenue account will be kept.

7. Maharaja Holkar undertakes to give all reasonable assistance to the Engineers employed on the Railway in respect to labour, materials, etc., the Railway authorities paying for the same.

INDORE PALACE;

The 28th April 1870.

And even in the final confirmation of the Treaty by the Viceroy, the Maharajah secures the additional privilege of having *his Interest free of Income Tax.*

This agreement was approved and confirmed by His Excellency the Viceroy and Governor-General in Council at Simla on 25th May 1870. His Excellency in Council also agreed that the payment of 4½ per cent guaranteed interest **will be made without deduction from income tax.**

Simla, 10*th August* 1870.

For a similar loan, however, the terms given to the Gwalior Durbar are much less advantageous.

out of every four rupees of such receipts *i.e.* about 27 crores at the least in round terms. Admitting the necessary deduction of the proportionate share of working expenses (Rs. 18 crores), even though the charges in the States are not invariably as high as in British India : and for a part of the Interest on Railway indebtedness, (about 5 crores), which has often been materially and needlessly, not to say unjustifiably, inflated by the Government's policy of paying a 25% bonus on the market value of the stock of each Railway Company at the time of its acquisition by the State, there is still a balance, on proportionate basis, of nearly 4 crores distributable in the States. In fact, however, they get nothing from the railway surplus.

(3) The States, debarred from this direct return, can get no consolation from any substantial indirect benefits, clearly shown to be due to the advent of the railway in their midst. At the time when the railway enterprise was new, unfamiliar, unprofitable, the States were told of innumerable indirect advantages accruing from the mere fact of the opening of a railway in a territory. So far as the Indian States are concerned these advantages have proved as hypothetical as ever. To them the strategic value of a railway has no significance. If anything, the Railway in their midst exposes them to a swifter attack than ever before, if ever a State's relations with the paramount power become strained. And, as for the benefit to trade and industry, the States felt the first and direct consequence in the shape of a substantial sacrifice to their treasury due to the concomitant abolition of the Transit Duties, without any compensation in cash or kind. The general policy, moreover, in regard to railway rates is so arranged as to drain the State of all its potential resources in regard to production of new wealth within the State, flooding it at the same time with cheap foreign products, against which the indigenous article had no chance to hold its own. The Railway, once it came within the State, broke down thoroughly and for ever its old time self-sufficiency ; and brought nothing material instead to compensate for this change. Trade did develop, in a manner of speaking, thanks to the railway ; but the trade collectively was such, that economists as well as statesmen cannot but become most apprehensive on those developments. The Railway rates were definitely framed without any consultation with the States, so as to favour exports of food-stuffs and raw-materials to overseas countries, as well as stimulate imports of foreign manufactures which put out of the

market the domestic competitors. Through traffic from the interior to the ports was, and is, preferentially treated; in spite of clear clauses in the agreements and the specific provision in the Railway legislation to the contrary. The loss thus engendered was, and is, sought to be made good by imposing needless burdens upon the inland, inter-provincial, or interstate trade. In a manner of speaking, the whole country suffered grievously from this strange perversion of the Railway enterprise. But the States have suffered more than in proportion, not only because they are generally speaking inland blocks of territories, with no effective alternative to the railway monopoly; but also because, when the awakening did come at last upon the country as a whole, the States as such had little chance of the benefit being shared.

(4) Of the other indirect economic advantages, besides the opening up of the country. The States get as shadowy a share as in the case already examined. In the employment created by the railways, their people get little or no share, on the lines of the Government of India, as well as on those managed by the companies, the states have reserved to themselves no voice, nor share, in the patronage or prosperity created by the Railway business, and its connected industries. The absence of a predominantly Indian personnel in the superior ranks of the Railway Service; as also of any noteworthy creation of those industries which minister to the railway business generally, are felt in British India even more keenly than in the States. But the States feel it the more keenly than the British Indian people, as the former are still under the impression that they are independent, or at least autonomous authorities and governments. The States are conscious of having made a sacrifice for which they find no return, and little acknowledgement. They don't even get a return in the shape of technical training to their people. There is, indeed, no Railway College or training establishment anywhere in India. Finally, in regard to the purchase of Stores for the Railways, the policy has only recently been designed to give preference to Indian made articles suitable for the purpose; and naturally the States are yet a long way off from being able to participate in such an indirect advantage.

On these considerations, then, are grounded the main complaints of the States in respect of the Railways. They would not mind their concessions

of land and jurisdiction; their sacrifice of transit duties, and their own investment of capital in the Railway enterprise of the Indian Government, could they but assure themselves that they receive direct or indirect benefits sufficient to compensate them for these. That they get no adequate share in the profits is the least of their grievance. It is no reply to them convincing to say that railway earnings are not the same thing as tax-receipts; that if their subjects contribute to swell these earnings, they receive good value for their money in the shape of cheap transport service performed for them. They recognise, of course, the essential difference in the mulcting of their subjects for the benefit of the Indian Government in the name of the Customs Duties ; and under the excuse of the railway rates and fares. But the States still feel that in the division of the final surplus of net profits from the railways,—after all the working expenses, interest dues, reserve and depreciation fund contributions have been paid,—they ought to have a share in proportion to their population, which the Government of India does not allow them. In the last analysis, the profits are due, the sates feel, to the scale of rates and fares fixed at any moment ; and as that is settled by the Government of India without any reference to the States, and as there is a practical monopoly of the transport business in the railways, there is an element of taxation in the Railway receipts, which, the states claim, ought to be shared with them by the Government of India on some agreed basis.

The alternative of a right to the States to tax the Railway Companies on their earnings within the State jurisdiction is unlikely to be conceded by the Government of India, and so need not be considered in detail ; though the analogy of the American States, or even of some Indian municipalities may will be cited in sapport of this.

Ye another alternative is the capitalisation or amortisation of the States' interest in the railways ofall kinds within the States, so far at least as the Government of India lines are concerned. If all the claims of the States are to be bought out, however, the process would prove much too costly, not to say complicated, for the Indian Government. Even so, the claim of the States to some representation on the Railway Board, and to some voice in the moulding of the general railway policy of the country, will remain unanswered.

The economic case of the large-scale canals for commercial irrigation stands on a totally different footing from that for Railways. I cannot, however, stop, in this Lecture, to explain to you the comparative economics of railways *vs.* canal construction in India. The history of the income from the canals, and that of capital investment, is also different from that in regard to the Railways. But for this you must consult other works on the general subject of Indian Finance and Economics. From their very nature, the Irrigation works are fixed locally ; and it was probably because of this characteristic that, in the constitutional distribution of functions between the Central and the Provincial Governments of British India, these have been assigned to the latter. Inter-statal complications, however, arise in their case also; because more than one river flows through British as well as States territory, and so irrigation projects unavoidably concern the States as well as the British provinces in such rivers. Treaties have, therefore, had to be made with the States concerned, both in respect of common projects of joint enterprise, as well as in respect of separate projects by the States and the Provinces from the same river, in order to secure adequate supply of water to each of the riparian owners. In contrast with the Railway Treaties with the States, in the Irrigation treaties

in regard to common rivers, the British Government have always reserved their sovereign rights in the river bed, exacting even seignorage dues in many cases for this purpose. The Treaties also regulate meticulously the supply of water, the maintenance of works, and of the staff, and also the leving of rates for the water, or the principles for disposing of the land reclaimed for cultivation, thanks to the aid of the irrigation works.

The contention of the States, on a careful examination ol the position in this behalf, appears to be—

(1) that the policy in respect of the railways and the irrigation works, in its bearing upon the interstatal relations, has not been on a par. Irrespective of the basic difference in their respective effects on the productivity to the country, the States have to conform to the ideals, conventions and practices established in British India, regard less sometimes of their local conditions. Those States, indeed, which have had no original resources of their own in this regard, cannot but agree to the proposals of the British Government. But to the States who have their own claim to the river-water, concurrent if not prior to that of the British Government, cannot be silenced by a mere reference to prescriptive right. It may be that many old works in the State territories may have fallen into disuse owing the period of disorder. But is that a good,—a just—reason to bar such States from a revivalist programme by a reference to the prescriptive rights? On the other hand, the charges by way of seignorage, slight as they may be, relatively speaking, are also an unfair exaction considering the Railway treaties, and the States generosity in that case. The States may fairly claim, therefore, a revision of the basic policy in these respects.

(2) The ideal here adumberated can be achieved only by holding the water wealth of the

country to be the common property of the peoples of the land whether living in the States or in British India. Since everybody is equally entitled to a share, if geographic and physiographic as well as engineering conditions permit the same, no authority must be permitted to debar others from utilising this common property on grounds of prescriptive priority, nor to levy a tax as an index of the rights of sovereignty. The practice now well established to construct such huge works by common contribution of capital and operating expenses in proportion to the benefit received may be maintained. And the analogy of the Railway policy may so far be followed as to insist on every state, lying along the line of march, and capable of receiving the benefit from such works if constructed, being not permitted to refuse to join in the consortium. Even the policy of letting out the land so reclaimed, or charging the water-rates on such compulsory supplies, might so far be assimilated as to attract an equal proportion of fresh capital into the agricultural production under each participating Government. This need not, of course, mean a needless interference in the land revenue policy of each State or province; but there is an easily recogniable margin between needless and undue interference, and reasonable regard to the solidarity of the country's economic development.

Post Office Receipts.

The Posts and Telegraphs make the last of the items, which are in the nature of an income from public enterprise, exclusively assigned to the Government of India. The theory of postal revenues in India makes that Department rank as a commercial concern ; but its accounts do not by any means show any substantial profit. Still, the Indian Post Office is not meant to be purely or principally a service to the people, as is the case in the United States of America. Its charges therefore, are not

framed exclusively with regard to the ability of the people to bear them. The postage rates have been substantially increased in India under the post-war stress, indicating an affinity to a tax revenue which cannot but be condemned. The Indian Post Office is also open to criticism in regard to the comparative backwardness, or clumsiness, of those incidental services, which the corresponding Department is made to render in much greater profusion in western countries; and which would be even more appreciated in India than in those countries. The Indian Post Office does the goods carrying business, under the name of Parcels, to a needlessly limited extent. It does a banking business under heavy restrictions, and confined to the transmission of funds from one place to another at heavy rates, as well as of keeping Savings Bank Accounts under regulations, whose one object seems to be to make the service as inaccessible as possible. In each of these cases there is so much room for improvement; and there is, besides, so much virgin field still left to be covered by an extension of the postal activities,—such as a system of universal insurance against most, if not all, of the contingencies of modern working lives,—that the hope of a substantial profit from this source is not utterly chimerical.

But such as the Post Office is, the full benefit of it is not equally shared with the States. The Postal service, like the Railways, is a creation of the British regime; and though some States have had the daring to institute their own Post Offices, the economy of as large a scale of operations in such matters as possible cannot be denied. The Treaties with those States which maintain their own postal service provide for a free exchange of correspondance between British or other States' post offices, and those of the States with such special treaties. The same rates of postage to ordinary

correspondance, registered or unregistered, parcels carriage, and the carriage of value payable articles prevail; and the same Regulations apply to the payment of compensation for loss of registered articles in the case of four out of the five States which even now maintain an independent Post Office of their own. But these are all facilities to secure the fuller advantages of uniformity in administration. They do not and cannot obscure the fact that these States, *Viz.* Hyderabad, Patiala, Jhind, Nabha, Chamba and Gwalior, seem to have recognised the value of the Post Office as an emblem of autonomy, and, more still, as an innocuous and plentiful source of revenue.

For the States who have no independen Postal Service of their own, the British Post Office renders the service of free postage for State correspondance; but that ends the tale of the direct advantages to the States from the Imperial Indian Post Office. The telegraph branch is now merged in the Postal service; but separate conventions for almost every leading State have been concluded to regulate the construction of telegraph lines in the State territory, and charging the latter for maintenance, if not initial establishment. The peculiarity of a monopoly of public service seems to be overlooked by the those who still hold the charges on the combined Post and Telegraphs Service in India as being merely a fair price for service rendered. The States, however, feel that their subjects have to bear the burden,—so far at any rate as these rates may include an element of burden,—without their treasury benefiting in any way. The mere fact of the monopoly makes this feeling inevitable, though there is an obvious *quid pro quo* for the postal service charges. The States also realise that the British Indian Post Office opens branches in State territories for reasons of its own profit; and that from the profits of the postal

business, the British Indian Government have built up handsome properties in the States, in which the latter have no claim. The possibilities of further extending the postal activities, in the domain of banking and insurance, for example is not welcomed universally by the States; partly because that aspect has yet to be appreciated by them, but partly also because they see only their own exclusion from such benefits, as may result from these extended activities.

In those States, again, which maintain their own independent Postal Service, the feeling of an unfair rivalry between theirs and the British Post Office is by no means altogether unknown. On lands primarily acquired in these States for *Railway* purposes, the Government of India have erected Post Offices, which do a roaring business within the technically British territory, but to the immense prejudice of the States concerned. The States also feel that they are not getting that full freedom of interchange on equal terms, which are customary between two mutually autonomous countries under the Postal Conventions: or which was provided for in the special Treaties they have themselves concluded in that behalf. The States, in fact, feel that whether or not they have an independent postal service of their own, they must accommodate themselves to the requirements of the system laid down by the paramount power, and have no right to develop independent postal policies or activities off their own bat, even though the specific treaties in that behalf contemplate nothing but the usual equality of treatment as between two independent States. Altogether, the postal services, and other activities carried on through that Department, to give perfect federal satisfaction, must be more equitably distributed,—not necessarily in the sense of sharing the monetary profit in some agreed proportions, but so that the rendering of the service

may leave nothing to be desired. This service must, of course, be centralised; as also its pecuniary profits or losses; and the existing Treaties with particular States must be modified in so far as they stand in the way of such a consummation.

I shall consider the Mint and Currency receipts of the Government of India, when discussing the bearing of the Monetary system as a whole on the national economy of India in the concluding Lecture.

The Indian States Expenditure, and the Cost of National Defence.

I have so far been discussing the Revenue aspect of the Indian States finances; not because I am unaware of the decisive influence of Expenditure in all matters of public economy, but because I want the more fully to emphasise the place of public expenditure in shaping the national economy. The Indian States financiers may be backward in their grasp of the scientific principles of public finance. But they cannot help realising that the limits so rigidly set upon their activities or ambitions by restrictions on their revenue resources, in these diverse ways, must inevitably circumscribe their ability to spend usefully for their people and their territory. The theoretical writer on Public Finance makes it a remarkable point of distinction between public and private finance, that whereas in the latter the limit of activity is rigidly fixed by income, in the former the deciding factor is expenditure. Income must be made to conform to indispensable expenditure. The theory, however, of elasticity of resources in public economy is true, with limitations, only in respect of perfectly independent States. And hence the blame often laid at the door of the Indian States, for their lack of productive or beneficial public expenditure, overlooks this most important limitation of the States'

finances. Speaking generally, public expenditure in the Indian States is rather ministerial than beneficial. But there are States in India, whose expenditure per capita on such useful items as Public Instruction, or material development, compares most favourably with even the most prosperous British provinces.* Despite the seeming dead-weight of the Palace charges in almost every State ; despite the still persisting uncertainty in regard to the proportion or amount of the Princes' Civil List in many States; the bulk of the public expenditure in the States can show, I venture to suggest, as good value received for every rupee spent as in many parts of British India, and far more so than in the case of the Government of India's own spending. And if, in particular cases, practice differs remarkably from such principles or professions as these, the remedy lies, I suggest, in setting up an authority, strong enough to check such variations, rather than in merely abusing the States for their defective financing collectively. In so far as the elementary principles of public economy have yet to be understood by many a State finance minister, the room for such improvement may be even more considerable than an outside critic may feel himself justified in consfidently asserting. But, even after allowing for this margin, the fact cannot be denied to-day, that the scope of public activities and services is unduly restricted in the States, as things stand, for no great fault of their own alone ; and that, if all parts of the Indian federation are to develop equally and simultaneously, the redistribution of resources as well as obligations would have to be attempted on a more scientific basis than has been done so far. All the suggestions for refund or compensation to the States

* Cp. Table on p. 228-31. The Nizam spends nearly a shilling per head, while Mysore spend 16d pe head of population, as against the British Government's 6d per head on Education.

on the several grounds considered already, have, of course, been made by me on the assumption: that the States would employ the increment in their revenue resources thus provided productively for their territories, or beneficially for their people. If institutions or guarantees are lacking effictively to assure the minimum requirement for any such reconsideration of financial resources as I have indicated, steps must be taken forthwith and unambiguonsly to provide them, so as to avoid any possibility of an abuse of these increased resources. In this matter, the States or the Princes should not, in my judgment, be suffered to plead their treaty rights, or theoretical independence to excuse them from compliance with a standard minimum of service to the people. Judging, however, from the resolutions of the Princes' Chamber at its last sessions, I do not think there is much ground for anxiety on this sosre.

Against the main contention of the States that their revenue resources are unduly restricted by the policy of the Government of India, the Government of India generally reply that, if they take a disproportionate share of certain revenues, they also shoulder exclusively the entire cost of the military defence of the country. It is, of course, nothing unusual for the federal government to shoulder exclusively the task of national defence; and so, even if the contention of the Government of India is strictly true in this behalf, they do little more than what isthe common practice in all federations. As a matter of fact, however, the statement is not true that the Indian States take no share in the cost of the country's defence. It is well understood, in quarters responsible for the purpose, that, of the total army in India, a certain proportion is for purely defensive purposes, or rather for internal security, the remainder being a margin for more aggressive tactics, if necessary. What this pro-

portion is precisely may not be commonly known ; but judging from the total cost to the Indian Government,—say Rs. 55 crores per annum for a defence provision of all arms ; and assuming four-fifths of this to be for purely internal security purposes, the cost thereof is Rs. 44 crores to the Indian Government. The Indian States, or the most considerable of them, maintain, and are by Treaties bound to maintain, a certain military strength of their own, which, to that extent, acts as so much automatic contribution for the maintenance of internal security, and the provision of national defence. The fighting value of these Indian States armies may, on modern standards of European warfare, be relatively inferior. But if that criticism is well founded in fact, the blame lies rather on the shoulders of the British Government, and their Treaty provisions in that behalf, which have aimed at rendering any military forces entertained by the Indian States to be practically ineffective as a weapon of offence against the British Army in India. And, on the other hand, many competent authorities consider the British Indian defence provision to be unduly costly, because it is founded on consideration of European rather than of any likely Indian frontier warfare. To the States, however, such troops as they still continue, and are allowed by Treaties, to entertain, cost substantial sums; even though the only use they make of such troops is ceremonial rather than for effective fighting. The States have an aggregate military strength of some 50,000 troops in their own armies, against the effective fighting strength of the British Government's standing army of about 230,000 men of all ranks. This is more than a fifth of the total British strength, including both the troops for internal security, and those for defence as well as aggression on or beyond the frontier. In proportion to their population as well as wealth, this is by no means a defective contribu-

tion by the States. We cannot say precisely the total amount spent on these troops by the States collectively; but the rate of spending is necessarily more economical in the States than in the British army, with its standards of European competition, and its considerable proportion of non-Indian and disproportionately costly *personnel*. Moreover, though the States maintain these troops primarily for their own defence, they also act for the States as a kind of insurance against too sudden and too heavy demands upon them in the cause of Imperial Defence. In the last World-War, the Indian States contributed freely in men and money and material, the full pecuniary value of which it is impossible to assess exactly, even though the War had no immediate interest or concern for them. The lowest computation would value this contribution at over 20 crores of rupees, equivalent to an annual charge of 1 crore in interest, which, again, does not compare unfavourably with that of British India.

Besides the States troops proper, there are Imperial Service Troops maintained by the Indian States, definitely for service in Imperial wars. These aggregate some 32,000, and cost the States roughly 5 crores or more per annum. Together with the cost of their own troops, not less than another 5 crores; and the Tributes paid by the several States,—historical remnants of a vanished past,—the aggregate money contribution of the Indian States, regularly made every year, cannot be much short of 11 crores. Against 44 crores spent on the same object by the Indian Government, this is not a disproportionately small contribution by the States, considering their population and wealth, considering still more thier real interests at stake in Imperial quarrels, in which they have never hesitated to make their best contribution, notwithstanding the fact that

the strict letter of the Treaties might not bind them to do so.

In addition to all these, mention must be also made of the very considerable cessions of territory made by the several States, expressly to provide for the military strength required by or for their defence. In many cases even now these territories are known as Ceded Districts, or Assigned Territories. The revenues from these would, in the aggregate, more than suffice to make up for a just contribution from the States towards the cost of the national defence. It is arguable, indeed, that these revenues would not have been what they are to-day under British administration, had the districts in question remained under the relatively backward Indian States rule ; though, of course, the States would feel themselves in duty bound to repudiate such a proposition. But even granting that proposition, the original revenue from these assigned tracts, with the same expansion as in the remaining revenues of the States,would more than make up, I believe, the just proportion that may be legitimately expected from the States towards the cost of our national defence.

Finally, the personal factor involved in this question must also not be overlooked. The States feel very acutely the fact that, while they may at any moment be called upon to contribute to the best of their ability in fighting British Imperial quarrels, in or outside India, they,—the States,— have absolutely no share in shaping the foreign policy of this country, on which hangs so much the problem of the cost of national defence. Unless and until, therefore, some kind of a machinery for common consultation and joint action is evolved to determine the line of policy in this regard, the States cannot but feel a standing grievance against the prevailing policy of Imperial Defence, with an ever

imminent menace of active fighting. The task of the national defence of India on all frontiers, by land or on the seaward side, being a British monopoly, the latter have so ordained the recruitment and equipment of the military and naval or air forces, that the States get less than their fair share of such work in the common defence of the country. The martial spirits among the Indian peoples are found, in the greatest proportion, in these survivals of India's ancient military renown. But the British Indian Government would not, for obvious reasons, recruit its forces from these sources ; and so to the States is wrought a double injury, first, in finding on their hands a considerable proportion of unemployment in those classes of *their* people, which cannot find congenial employment outside the military forces; and, secondly, because of the consequent difficulty in co-operating with the British forces in time of danger, since their bases of organisation etc. are so different. The questions, therefore, pertaining to the Foreign Relations of the country as a whole, and those concerning the recruitment, organisation, equipment and disposition of the military forces of the Government in India must be decided, in principle at least, by common consent in the joint councils of the Federation, if the fullest possible co-operation is to be received from the Indian States towards our national needs for defence. Personally, I am by no means satisfied that the present-day principles of army organisation, disposition, equipment and recruitment, even for British India, are, financially as well as militarily, the most effective as well as the most economical that we can devise. It may quite possibly be, that the principle of separate local militias, for the States as well as the Provinces, may have to be evolved for the greater security and better defence of the country. I see germs of that idea in our several University Training Corps, which may well be the forerunners of more effective

ocal militia, and greater or more abundant reserves than India can command to-day. But however that may be, I think it absolutely indispensable, if the federal government in India desires a proper contribution towards the cost of the national defence from each constituent element, to have a common federal council, in which every part of the Federation should be adequately represented, to determine the basic policy in these matters, before we can justly demand proportionate contributions; and, in the meanwhile, the Indian States take, in my opinion, more than their fair share of this particular part of our national burdens.

As regards the other branches of the public expenditure in the Indian States, the irresistible force of imitation has compelled them to introduce terms and conditions of service in their governments, which cannot but add disproportionately to the cost of administration. The States could render to their subjects the same, if not a better, degree of administrative service, at a much lower cost, if the constant example of the far more costly British system was not before them to demoralise their public service. Every time a State takes on loan the services of a British Indian officer,—and such loans are very frequent--the pay &c. of such a borrowed officer are inevitably on the British Indian scale ; which cannot but react on the ideas of the States officials as well, and so raise the cost of their administration. New departments of administration have, likewise, been added in the States, more often from reasons of imitation than because the States have fully realised the utility of such departments, also to the considerable increase of the cost of administration. The States do not complain much on this score; though it is quite a different story as regards their peoples, who have to bear these uncompensated burdens. But what the State governments as well as people particularly

resent is the fact that in the common, objects of public expenditure in India, the States subjcts are treated invidiously by the British authorities. Take the case of a University in a British Indian province. The States can understand that the special advantages attached to this activity may be confined to the British Indian citizens, *e. g.* in respect of public scholarships, or recruitment for government service from the ranks of these University graduates. But what they cannot understand, and will not excuse, is the tendency in some British Indian Universities to exclude students from the Indian States on one or another pretext, or even to refuse to affiliate colleges in the States territories, as they had hitherto been doing. Individual States are not always rich or enlightened enough to maintain Universities of their own, like Mysore, Hyderabad, or Travancore; and co-operative action among a group of States on matters like this, though sure to be developed in the near future, is for the present very much handicapped by the diplomatic precedents and usages,—not to say public Treaties or personal prejudices.

Under the circumstances, the only result of such exclusiveness on the part of the British governments is to engender a feeling of just resentment in the States, *Viz.* that while British India is most anxious to secure every possible advantage for itself from the States, it is by no means equally considerate in return. This bodes ill for a sound and successful federation in the near future.

Further analysis of the details of public expenditure in the Indian States, either absolutely by themselves, or even by way of comparison, contrast or correlation and constructive suggestion, would be outside the scope of these Lectures, even if the project was not already for beyound your patience and indulgence to me for this very lengthy Lecture.

LECTURE VI.

FINANCIAL ORGANISATION AND AUDIT, NATIONAL DEVELOPMENT AND RECONSTRUCTION.

I propose in this Lecture to consider briefly certain topics, intimately connected with the financial administration of a country like ours, which have a peculiar importance in a federal organisation. You are not to look upon these as the odds and ends of the subject, which could not conveniently be brought up under the more outstanding and natural divisions of the subject ; and have therefore to be run over in a concluding and summarising Lecture. But perhaps it would be best to leave you to judge for yourselves as to the relevancy and importance of these matters, when you have seen their outlines I am going to place before you.

The public finances of any country, unitary or federal, have a most vital bearing on the general economic development of that country. It is not merely that proper financing for a great nation demands the most scrupulous lay-out of the public monies, so collected from the citizens as to make their contributions the least burdensome to the contributories ; and so laid out as to make every ounce of public wealth yield the utmost service or profit that could possibly be obtained from it. More important than this, though perhaps much less obvious, is the aspect of public finance, which directly ministers to the increase of the national prosperity and welfare, as much by rendering the most plentiful services to the community, as by

developing its resources, and securing its material as well as moral interests. The mere raising of adequate revenues, or their proper spending, is a fraction of the task comprised in this aspect of public finance ; there are connections and ramifications of these activities and outlay, which serve the economic interests of the people concerned in diverse ways invisible to the uninitiated or the superficial ; but they are not for that reason the less to be considered and attended to by the public financier, who would not have the good he seeks to do in devising sources of revenue and their layout undone by these unseen but not ineffective forces.

The most considerable of these hidden springs of financial machinery is that comprised in the Currency System of the country, reaching out by its tantacles upon the credit organisation of the community, and affecting therethrough most vitally the entire mechanism for economic development. The problem in India is complicated for reasons of our monetary history, into the details of which it is inexpedient to go in this Lecture. Suffice it to note that the problem is created because of the Indian States' demand for a share or consideration in : (1) the profits on metallic coinage, that, under the existing monetary system of India, used, until very recently, to amount to considerable proportions; (2) receipts of the Government of India, under the head Interest, which is the result of the Interest on the Securities held in the several Currency Reserves ; (3) a fair treatment in respect of currency manipulation, or control, reaching on the credit system of the country as a whole, to the interests of the States; and (4) an adequate representation of and consideration to the States in such institutions as,—like the proposed Reserve Bank, or the existing Imperial Bank of India,—are old off to work this mechanism.

(1) In considering this fourfold problem a little more in details, it must be premised that the problem affects only the States in relation to the Government of India, and does not concern the British Provinces materially. For the control of the currency and credit system, through the monopoly of the monetary mechanism, is much too commonly recognised as the function of the federal government to be questioned by the Provinces that make up that Federation. It is conceivable that the actual manipulation of this mechanism may give rise to discontent as between provinces, because the economic development and interests of the several provinces may not be identical. But the remedy for such apprehensions lies in the influence such provinces can wield in the central legislature, which controls and formulates the basic policy in regard to this mechanism. Most constituent units in a federation would, as they ought to, be content with this answer. But the case of the Indian States is radically different. Whatever the fact of the Indian political organisation, the fiction has consistently been maintained in this country, that the States are independent units, with full sovereignty at least for internal administration purposes. And, of the emblems of this sovereignty, none has been prized so much as the right to have their own monetary system. The existence, however, of a number of different monetary systems in a country cannot but affect most prejudiously the internal trade of the country, and the movement therein of capital and labour from one part to another. By Treaty and persuasion, if not also by a certain amount of indirect compulsion, a majority of the States have been made to see the futility of maintaining their own separate mints, coinage, and currency systems in general. The vicissitudes of the Indian Currency system, however, after 1893,—when the free coinage of the standard silver rupee of India was stopped

by the Government of India at their mints,—have been so great, that the arguments and considerations, which must have governed the States consenting to discontinue their separate currency systems at the time, must have been very appreciably modified by now. No thought of a profit from rupee coinage was entertained in 1893, or even in 1899—at least in so far as such a profit were to be regarded as ordinary revenue of the Imperial Government. Hence the States consenting to a centralised mint and coinage might well argue, that they gave their consent to achieve a common convenience, and not to procure an exclusive source of revenue for the Government of India. And now that this privilege has become a source of ordinary, handsome revenue, these same States might well ask for a proportionate share in these profits, if, as I hold, they would not be suffered so far to undo the trend of recent developments as to denounce these Treaties and restart their separate mints. Not all the States have, even now, surrendered, it may be mentioned, their right to a separate mint and coinage as well as currency system. The example of the Nizam's Government,—the most considerable in the land after the British Government,—is not lost on the smaller States in this behalf. In 1893, the British Government were most anxious to prevent any addition to the rupee stocks of the land, which would stultify their policy of bringing about an appreciation of the purchasing power and exchange value of the Rupee, by the simple method of creating a scarcity. They were at pains, therefore, to induce the States, with a separate monetary system of their own, to forego that right. In the years that followed, the policy adopted in 1893 began to shape so as to bring to the Government of India very heavy profits as the result of their coinage monopoly, and thanks to the complete divorce in the price of the rupee as a bit of silver, and as the standard coin of the Indian

Empire. These profits were, at first, set aside to form a Reserve,—the so-called Gold Standard Reserve of later fame,—intended officially to facilitate the introduction of a working Gold Standard in India, when the Government of India felt themselves to be ready for the change. But the process of accumulating vast amounts of liquid capital in this way was so simple, and the temptation it offered so irresistible, that the Government of India insensibly underwent a change of views with reference to this special fund, till they even came to overlook the *raison d'etre* which brought it about. The States, who had, under Treaties, to seek their own supplies of the current coin at the British India Mint, did not realise all at once that every time they or their subjects required additional rupees into circulation, they paid a heavy indirect tax to the British treasury, or rather helped to swell the Gold Standard Reserve. Much less could they realise that,in the near future after 1899, the number and occasion for coining additional rupees will be decided upon exclusively with reference to British Indian needs, being at the absolute mercy of the Government of India. How could the majority of the States realise in those days that the power to control and manipulate the volume of currency in a country, as also to maintain by administrative action the exchange value of its standard coin, is a mighty weapon to influence the entire economic organisation of the country, and the conditions of its welfare? By contracting or expanding the volume of the legal tender in the country, the authority which exercised that power exclusively could mould the general price-level almost entirely as it liked. And the minor consequences,—at least they seemed to be minor in the perspective of those days,—of the general policy in this behalf,—suchas the help these accumulations rendered to the public credit of the Government of India, the service they did in

facilitating the yearly borrowing programme of that body, and often supplied bodily the funds required; and the direct benefit it yielded in the shape of interest on the invested portion of the accumulation,—all these were hardly even perceived.

(2) The European War of 1914-18 has, however, served to focus the attention of the States to this matter in a manner that hardly any other single factor could do. The Government of India were, after two years of the War and its artificial conditions, unable to maintain the bargain they had tacitly made with the Indian commercial world to supply unlimited rupees at a fixed ratio with gold. They tried to coin as long as they could obtain silver on profitable terms; but the War had completely revolutionised the silver market, and destroyed the profit of the Government of India on silver coinage. They then had recourse to inflating their paper-money. This, however, brought a heavy rise in prices, without assuring anything like a parity of exchange for the rupee; and even brought the Government of India on the verge of inconvertibility, which the orthodox financier regards as only one degree less heinous than absolute bankruptcy. They were thus driven to disown the bargain, and reconsider the position of the rupee and its ratio in exchange, absolutely *de novo*. Into the details of these changes, it is unnecessary to go in this Lecture. The point, however, to be noticed at this stage, is, that by this time the States had realised their plight sufficiently to make insistent demands on the following particulars:—

(*a*) The Gold Standard Fund, amounting to £40 million, and made up out of the profits of rupee coinage, in which the States have had their contribution as much as the British Indian people, ought to belong in a fair proportion to the States, and for the rest to British India. The Government of the latter have, however, treated this

Fund, not as reserve or trust money, as originally intended: but as their exclusive property, to be utilised as and how they needed. The Fund has been invested, almost entirely in sterling securities, which are taken to be equivalent to gold for all practical purposes. It is not so very long ago, however, that sterling money had ceased to be the same thing in practice as gold. But overlooking that point, the question still remains as regards the disposal of the *Interest* from these investments. That interest now-a-days amounts to some 2.7 crores. If the States have contributed per capita as much as the British Indian people,—the States' need for metallic currency was, as a matter of fact, much greater all through this period, owing to the more backward condition of banking in those parts,—they ought collectively to be entitled to a fourth, at least, of this Interest. And their right to a proportionate share in the capital value of the Reserve should, in fairness, be similarly acknowledged, together with the assurance that the disposition of the Fund will not be made, except after previous consultation with the States.

(*b*) The more considerable factor in the Indian currency system to-day is the paper money. issued by the Government of India as an exclusive monopoly. A portion of the paper money so issued is covered by a metallic reserve ; but another, and no less considerable portion, is covered by securities, mainly of the Government of India. As in the case of the Gold Standard Reserve, so in this case of the Paper Currency Reserve, the States might fairly urge, that the present volume of paper money in use has come to be, what it is, because their people, along with those of British India, have consented to use this substitute or representative money ; which thus enables the Indian Government to make investments, or obtain handsome returns by way of Interest. The total income shown under the head of Mint and Currency, in the Government of India's Budget, is about 2.5 crores, made up partly of the balance on exchange transactions, and, for the rest, of this Interest on the securities in the Paper Currency Reserve. The States feel they are entitled to a *pro rata* share in this income of the Government of India taken by the latter as ordinary revenue.

The capital of the Fund in this case is on a slightly different footing from that of the Gold Standard Reserve Fund. In the case of the latter, the States, like the people of India, might well ask if the figure now shown as making up the total capital of that Fund, is the real amount a c

cumulated by the people of India, and the coinage of rupees made by the Government of India, since 1900. That coinage has been estimated, at a modest computation, to aggregate more man Rs. 300 crores ; and, given an average profit of 30%,—by no means a preposterous figure,—the total of the fund ought to be nearer 90 crores than the fifty odd crores now accounted for under that head. What has become of the balance ? But perhaps it would rake up too many distressing memories to probe deep into this matter. We shall, therefore, pass over it, with just this remark : that whatever the fate of this Reserve, it ought to be a warning to the people of India ; that anyhow the capital of the Paper Currency Reserve, in the fiduciary portion, is still mostly in India ; and that the fair claim of the States should be acknowledged by a *pro rata* refund of the interest earned on the fiduciary portion of the Reserve.

(*c*) In general, also, the States cannot but have suffered by these repeated changes in the standard of currency,—the changes being all made by the Government of India alone, and for their own reasons. The States, however, are interested, as producers of raw material mostly ; and hence they cannot but have felt the successive rises in the exchange value of the standard of currency in India to be to their material disadvantage. They have, however, not complained on this account ; but that does not mean that their point of view, and their interests in this connection, ought not to receive any attention by the powers that be, in the future.

(*d*) The States, finally, are interested, like any other party, in these currency changes, as debtors and creditors. Any artificial appreciation of the standard of payments must benefit the receiver ; and any depreciation, the debtor. In so far as the States are predominantly debtors, the recent, currency changes cannot but have affected them prejudicially ! Even if we should not cry over spilt milk, we must not ignore the need for precautions against a repetition of such events in the future. For the development of a deep, sound, abiding, federal sentiment, these are matters which cannot receive too careful an attention.

(3) I have already indicated the connection of the monetary and currency system with the larger question of economic prosperity. The power to expand or contract the currency must, in a country like India, affect very materially the margin of

liquid capital available at any time in the country. Thanks to the policy they have hitherto followed, the Government of India have been obliged, unconsciously, to contract or deflate the volume of currency,—or at least to prevent its expansion to the point that the legitimate demands of expanding trade and industry would have carried it, in the absence of the intervention of the Government. How much harm they have wrought to the economic development of this country by this policy, it is impossible to estimate. But whatever that damage, the people and regions in the Indian States have suffered as much as those in British India. If this suffering and loss are to be avoided in the future, it is, indeed, not necessary that the function of currency and credit control should be decentralised, or that the Government of India be divested of it. No other government could be charged with this truly national function. But, precisely because the function is so distinctly national, and has such an intimate bearing on the prosperity of the country as a whole, the responsibility will lie doubly on that authority to take no steps without first assuring itself, beyond the possibility of a doubt, that in the measures it proposes to take,—in the manipulation it makes of the volume of currency,—the fair claims of all the constituent parts of the federation are duly taken into account, and their legitimate interests duly safeguarded.

Apart from this influence of the currency and monetary policy upon it, the general question of the economic development of the country, from a much wider standpoint, also leaves much to be desired, from the point of view of the States. They do participate, in a manner of speaking, in many of the benefits that result from the British Indian projects of material development of the country, its resources, or its people. The country, despite its size, is really an economic unity and integrity,

fundamentally speaking ; and so it is inevitable that, from measures of material utility, all parts of it benefit in one way or another. What, however, the States feel, as a grievance is, that in the planning of these projects of general material development, as well as in their subsequent administration, the interests and requirements of the States' territories and peoples are neither primarily, nor even simultaneously, considered. That, they urge, is not as things should be in a proper federation, in which the aim of the Central Government ought constantly to be to minister as much as possible to the needs of all parts of the federation simultaneously and equally. I have already mentioned individual cases of public expenditure in British India, in which, though the States people are unavoidably involved, the benefit to them is indirect, and almost grudging. In the more general question of supplying capital, let us say, for hastening the march of economic development, the States are handicapped muchmore than seems to have become apparent even to them. By bitter experience in the past, the British Government of India have learnt the lesson, which inspires that clause in the Government of India Act, that forbids any European British subject to lend money to the Indian States without the previous sanction,—is it also the consent ?—of the Indian Government. *The Government of India acts, now-a-days, as the common borrower for all the British governments in the country. But the capital needs of the States are never considered by that body, though the States have as many opportunities of profitable and productive investment of capital as British India, taken collectively. The States have a relatively poorer credit, at least in individual cases ; and so, if and when they resort to the open market for borrowing for productive purposes in their territories, they are forced to grant far more onerous terms to the lender

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*** Cp. S. 125 of the Government of India Act of 1915.**

than the British Government of India habitually grants. If the Central Government acted the banker or the financier for the States, as much as it does to-day for the Provinces; and loaned them the capital required under terms and conditions that may be agreed upon, generally as well as particularly, in common conference, the march of the country's economic development would be very much accelerated. That, in its turn, will react most beneficially upon the public finance of each part of the federation, either by avoiding the necessity of additional taxation to the extent of the profits derived from such works ; or at least by increasing or improving the taxable capacity of the people. This aspect of the case is, however, hardly yet realised by the financiers in British India, or the States ; and, for my part, I see no way of having it fully realised and given effect to, except by drawing closer the liens of the federal sentiment. Even in the more obvious case of the Fiscal Policy, the States have good reason to feel that *their* interests and requirements in such matters are seldom consciously considered and given effect to by whatever measures the Government of India adopt in such matters. If the States do get a benefit, it is unexpected and unintended. If they suffer a wrong or a loss, it is seldom considered. If they cheerfully bear the sacrifice—knowing it to be such, involved in a protectionist tariff schedule,—that is not counted as a credit unto them ; and if they protest against the injury, or demand a *quid pro quo*, they are treated with contempt, if not with fierce retaliation. This is not a happy ground for the seed of a federation to blossom in.

(4) The last group of the demands by the Indian States has both an economic as well as a constitutional importance. The Indian States have so far been allowed no voice whatsoever in the manipulations of the basic policy governing cur-

rency, and through it, the credit system and capital supply. The institutions which have operated this mechanism in British India, under or independently of the Government of India, have hitherto considered the British Indian interests exclusively, without a thought to the interests and requirements of the Indian States, their governments, or their industry. The laws or conventions which regulate the work of Banks in India,—*i.e.* of institutions specially devoted to the business of financing trade as well as industry in general,—have made it impossible for the Indian States to derive any benefit from these institutions, even in the case of a public, governmental, Bank. The principal banks in India are classified, usually, into four main groups : *Viz.* the Imperial Bank of India,—a semi-state bank in its constitution and working, acting chiefly as the Government Bank, and deriving through that connection a prestige which easily makes of it the most convenient Bankers' Bank ; the Exchange Banks,—mostly of non-Indian origin, doing particularly the foreign exchange business, and secured in their position, directly or indirectly, by legal provision and conventional understanding, which grant them a practical monopoly of this business ; the Indian Joint Stock Banks, mainly under Indian ownership and control, but not always Indian management as well, doing chiefly the ordinary banking business for the Indian commercial world in the chief centres of business ; and, lastly, the private Indian financier, known as *shroff*, who has always done this kind of business from time immemorial. Not one of these banks or banking houses have any direct interest or concern with the Indian States ; and much less is any of them particularly interested in the intensive economic development of the Indian States territory. The separates States' Banks, like those of Baroda or Mysore, workingeach in its own territory, do not get the support of the country's banking and credit organisation in general: and

hence are handicapped seriously in their work from the start. The opportunities for profitable capital investment and economic development are not a whit less plentiful and promising in the States, than they have already proved to be in British India. But the States are lacking most wofully in a sufficient supply of industrial capital, without which, of course, there can be no hope of their development. When the Government of India desired to develop Railways to improve trade; or Irrigation works to improve agricultural production, they found the necessary capital by pledging their own credit. And though that credit is now-a-days at the disposal of any provincial government in British India, the States can have no hope of enjoying a like facility. The Indian Government's credit is greatly fortified by their control of the mechanism of currency and credit, which gives them command of the several and substantial reserves of liquid wealth, built up in the past, as much by the contribution of British India, as by that of the States. To the States, however, no share is allowed in the indirect benefits resulting from such a command; and hence they cannot but feel that the first step to remedy this grievance of theirs is to secure a proportionate voice for themselves in the controlling authority for the banking and credit institutions now functioning, or proposed to be soon instituted, in British India.

The States' desire in this behalf becomes the more intensive when they realise that, as things stand, the existing banking institutions are practically debarred from assisting the States in the task of an intensive material development in their regions. It is absurd to assume, of course, that the British Indian authorities are jealous of the economic possibilities still remaining unexplored in the Indian States. But the fact, nevertheless, remains, that the Imperial Bank of India, for example, is

debarred from advancing money on the Indian States' securities, even of the most prosperous. The list of securities authorised specifically by the Charter Act governing the Imperial Bank does not contain any mention of the Indian States' loans; nor, indeed, is such a mention in the authorised Trustee securities in British India. On the other hand, under the practice now established by long and unquestioned usage, if any Indian State desires to tap the open market for a loan of capital, it must first obtain the sanction for floating such a loan for the Government of India. And it stands to reason that the Government of India would not grant such a sanction, if they could not approve of the objects of the proposed loan, or of the security offered for it, or of the provision made for the payment of interest and capital when due for repayment. Notwithstanding these precautions, however, the loans of the most prosperous Indian State are not reckoned in the schedule of the Imperial Bank's authorised securities for advancing money, even though a municipal loan in British India, or a Railway debenture, may command that facility. The Government of India does not, indeed, make itself responsible financially in any way for such States' loans as it sanctions and approves; but that is no reason to exclude those securities from the privilege here discussed, since such a grant would very much facilitate the capital problem of the States. And if the Imperial Bank is unable to assist the Indian States, how can we expect the other Indian or non-Indian banks operating in British India to do that business? For one thing, a provision of the Government of India Act precludes a British subject from making any loans to the Indian States; so that, if any bank were venturesome enough to engage in that business, it would do so at its own risk. The difficulty of the Indian banks is obvious, since they cannot utilise the Indian States paper,—supposing any of them

took the risk and began to invest in Indian States securities,—to raise liquid money,as and when they might want it, as they can do on any other paper in the list of the authorised securities for the Imperial Bank to do business in. The Indian banks cannot forget that, after all, the Imperial Bank of India is the sole source for obtaining liquid capital in times of stress; as much because it is in charge of Government balances, as also because it is through this Bank that Government would put into circulation emergency currency when required, and so add to the supply of loanable capital in the market. As for the non-Indian Exchange Banks, they find sufficiently lucrative business in their present monopoly of the foreign trade finance, willingly to risk their surplus resources in an Indian States loan.

The Indian States might want capital for a variety of purposes for developing their own productive resources in land, in mining, in forest and other industry, not to mention road and water transport, or the better organisation of the distributive business in their territories . The banking organisation of India as a whole is, it must be admitted, very deficient so far, in respect of the specialised institutions wanted for financing and developing the agricultural and industrial wealth of the country in every form, whether in British India or in the States. Any reconstruction in the banking facilities in the country would be futile, if it does not take into account these requirements, and provide, in the central State Bank, all the necessary departments, each specially devoted to the financing of trade, of industry, of agriculture, and of transport, as may be needed by the country, so as to co-ordinate the total financing activity of the country with a view to its more effective use. For the States, the imminence of such a kind of banking reorga-

nisation in British India has a grave constitutional significance; since, if they do not obtain adequate representation on the governing board of such an institution, they will wait in vain for the industrial development of their territories. The proposed Reserve Bank of India,—officially professed to be instituted for the better control of the Indian currency system, and through it of the country's credit system; and sought to be given the custody and use of the several Reserves connected with the currency system,—seems to have been dropped for the moment. But whenever the proposal is revived,—and there can be no question but that it will be revived in a near future,—the interests of the country would suffer materially, in my opinion, if the claims of the Indian States for a fair representation are not sympathetically considered, and complied with.

AUDIT

The same point about the need for a closer and more intimate, more constant, association of the Indian States, in the bodies or organs that shape the governing policy of the country, is driven home by the requirements of a proper audit of the public accounts of the country. I have already referred to the great importance of effective as well as efficient audit of public accounts, particularly in a federation and a democracy, in securing the due degree of national economy. Under the existing division of the powers and functions of Government, audit is an exclusively central subject, for British India. The justification for such an arrangement is not far to seek. Democracy,—and, at that, democracy in India,—is seldom competent to look efficiently after the financial administration of the country, and to secure full value from every rupee of public money spent. If this great requirement of sound public administration is to be secured in India; if the vast expenditure of our

Central, Provincial, States', and Local Governing bodies is to be properly audited, so that not only rigorous tally is had for the authority to spend with the amount spent, but also the necessity of any particular outlay, and the extent of good value secured therefrom is also enquired into and scrutinised;—then it would be indispensable to centralise the function of audit exclusively in the Federa Government, and to conduct it through officers responsible only to the supreme national legislature, and irremovable from their posts except for grave fault or incomepetence proved by the proper authority in the country. The States must be comprised in this arrangement if they really mean to obtain the full benefit of federating, just as much as the Provinces are included in the present audit arrangement in British India. The arrangement does not, indeed, dispense with the need for an adequate and efficient staff of accountants for each unit under its own authority; nor even with the need of frequent internal audit for the accounts of each such unit. What the centralisation here proposes to achieve is the assimilation of the system of public expenditure, which would enable the responsible officers, taking a comprehensive national view in each case, to say authoritatively whether the entire country, in all its several constituent parts and authorities, is getting good value for the mone it spends. Neither the States nor the provinces need dread the publicity that would result inevitably, if the suggestion here put forward were adopted, except and in so far as the financial administration in each such part is open to strictures by an impartial, outside, auditing authority. After all, the report of the Auditor-General will not be out till a year or more after the money has been spent. It will therefore do no great harm by its censure, and might induce lasting benefit through its suggestion. The very fact of publicity might help to remedy for the States that lack of industrial

capital, which the most advanced amongst them feel as the greatest handicap upon them.

CONSTRUCTIVE FEDERATION.

The conditions and arguments hitherto outlined must have sufficed to prove to you that the organisation of a suitable federation in this country would be incomplete, if, in some central place within the federation, adequate provision is not made for the due representation of all the several constituents of the federation, with their diverging interests and requirements, in so far at least as the latter may legitimately demand a special treatment. The States, included in such an organisation would no doubt seem to be in a permanent minority in the central federal governing institution. But if, on the other hand, their representation is based, not on population or territory, but on the *equality* of each governing unit with all the rest, there could be no possible injustice to any constituent of the Federation. I consider the model of the American Senate, combined with some suitable elements from the old German Bundesrath, or the new Federal Council, will not at all be impossible to work under Indian conditions. If in such a "Second Chamber" of the Indian Federation,—call it Senate, or Federal Council as you like,—every province and State is given an *equal* vote, irrespective of population or territory or wealth ; if, besides, a careful list is compiled of the subjects of common national interest, the basic policy in regard to which should not be promulgated, except with the advice and concurrence of this Federal Council of the Indian Empire,—there will be no difficulty in solving many of the problems I have glanced at in these Lectures. In some matters in relations with the States, such a Council may even be invested

advantageously with a dilatory, or a suspensive veto, holding up proposals of a given class for a period during which the people as a whole have fully considered it. I presuppose a regrouping of the Provinces, with a view to a greater degree of cultural affinity among the peoples included in any provincial area than is the case in the existing provinces of British India. And I likewise presuppose the grouping of the smaller States into single units, comparable, in size and wealth and population, to the Provinces of British India. Given this rearrangement, representation on a footing of absolute equality of these units of the Federation in the Federal Council may be secured to each by two representatives:—one the Ruling Prince, in the case of the larger States singly, and by elected deputy from among the Princes of the smaller States grouped together in a new unit for purposes of federal representation ; and, in the case of the British Provinces, by the Governor or president in each case; the other by the Prime Minister of each such unit. The Federal Council so formed would be a distinct asset in the better administration of this country, than has been the case ever before in the annals of the British rule, since its members would be experienced and responsible administrators, and its functions either confined to federal questions proper, or to revising and scrutinising and holding up definite proposals for change, whether put forward by the executive government or by the Legislative Assembly, until at any rate the country has fully considered them and definitely pronounced upon them. The Council may even act with advantage as an arbitration Board on interstatal, interprovincial, or federal questions, since its members would be more trusted and trustworthy.

The functions of the Federal Council will, of course, have to be carefully defined. It must never

trench, directly or indirectly, upon those powers of local autonomy in each constituent unit of the Federation, which would be the mainspring of sound federalism in practice in India. The division between the States and British India may even be maintained, in this schedule of the matters on which the Federal Council is empowered to advise, or assist, or concur in legislating. For example, while, in the case of the British provinces or their reconstructed representatives, the Central Federal Legislature may be given supreme powers in all matters in which the provincial legislature is not expressly authorised to legislate, in the case of the States similar action of the Central Legislative Assembly can only be allowed, if the Federal Council, having first considered the matter and satisfied itself, advises a particular course of legislation. Ordinarily, too, the Federal Council may be empowered to make legislative proposals for enactment by the National Legislative Assembly, on topics either exclusively assigned to the Federal Council to advise upon, or even on other topics which are considered to be of common interest. In the present German Republic, the Federal Council as well as the National Economic Parliament, are entrusted with this function of scrutiny and advice on legislative proposals of a technical character, which the ordinary national Assembly would not have time or energy or knowledge to do justice to; Though the national Assembly is not bound to accept these merely because the Federal Council or the Economic Parliament recommends them, the process go a very long way in clarifying the situation. Members of Government, moreover, are made, in the present German Constitution, answerable to the Federal Council, inasmuch as they may at any time be called upon to explain their measures and policies by that body, and may even be asked to take charge of measures proposed by the Federal Council for enactment by the Reichstag, though the

Ministers concerned personally do not approve of such a measure. If the underlying principle of such provisions are adopted in the redrafting of the Indian constitution, I, for one, have no doubt much of the present misunderstanding, injustice, or hardship would be removed, to the mutual advantage of all the parts of the federation.

This was a political, or constitutional, digression, inevitable for completing the constructive aspect of the proposals or suggestions I have been adumberating. I am afraid, however, it would be more than irrelevant for me to pursue this topic much further in this Lecture, tempting as that course might be. I shall, therefore, leave it at this point, with only the observation, that : in a country like India, we are bound to have common concerns, on which the particular interests of the individual members of the federation may not always coincide ; that if we desire to remove, or even to minimise, the resultant friction, it would be indispensable to evolve some such institution and practice as I have indicated. The outline given above need not necessarily be accepted as the perfection of federal suitability. But whether that model is adopted or not, some such mechanism will have to be instituted, if we would not have our political and economic development as a nation to be either arrested, or lop-sided.

CONSTRUCTIVE SUGGESTIONS.

Coming, next, to the last and the most formidable section of the Lecture this evening,—I mean the concrete suggestions for financial reconstruction in the light of the foregoing analysis and criticism,—I must preface the remarks that follow with the observation that : any suggestion for reconstruction hereinafter outlined must necessarily be treated as rough statement, the precise detail in each instance having unavoidably to be

worked out by the experienced staff of the Finance Department.

In considering suggestions for financial reconstruction, the scientific mind cannot but remember the overwhelming importance of the Expenditure side of the national balance sheet. We must, therefore, first define, as nearly as we can, the expenditure needs of the Indian governments, severally as well as collectively, before we can definitise the proposals for reconstruction. The field of Indian public expenditure has been reviewed more than once, since the establishment of British dominion in the country. But the review has seldom been comprehensive; and rarely has it been inspired by the motives of federalism which interest us in these Lectures. Whenever a Committee or Commission has been set up to consider the public expenditure of the country, that authority has interpreted its reference to consist in a review of the expenditure of the particular government setting it up. The task, I fear, was discharged by such Commissions rather as cheese-paring accountants, than as large-visioned financial statesmen. The last considerable review of the expenditure of the Government of India,—that by the Inchcape Committee,—merits this criticism *in excelsis*, though, within the scope of its task as understood by that body, its work was undoubtedly thorough. A mere demand for an all-round retrenchment, without any attempt to perceive the correlation between public expenditure and national benefit, can, if it is given effect to, only result in untold harm. Thanks, however, to the publicity attending the Inchcape Committee's findings and recommendations, the provincial governments in all parts of the country set before their similar committees of retrenchment a task, which, performed with a varying degree of efficiency, has resulted in a general feeling that there is everywhere room for

retrenchment, without giving any authoritative and reliable estimate of the irreducible needs of public expenditure, either in the Central or in the Provincial Government in British India. In the States, of course, there has hardly ever been a searching enquiry into the entire domain of state expenditure, even from this somewhat narrower point of view, with perhaps the exception of a model state like Mysore. It is, accordingly, impossible to say, with any degree of authoritative basis, what are the irreducible needs of the national service and government in all parts of the country, calculated with due regard to the possibility of material development from a proper layout of the public monies. All that we can do is to take up the existing scale of expenditure, and test it with reference, simultaneously, to the requirements and possibilities of retrenchment, and also to the needs of an irreducible minimum of civilised government and national service. The result will naturally be a rough approximation to the public requirements under the several constituent governments, that can only be accepted as a guide—and no more—for the direction in which we must travel, if we would reach the goal of national development.

It may be noted, at this point, as a general consideration affecting public expenditure in India that special provision needs no longer to be made by the Indian Government against three out of the four considerable bugbears of that government in the last century. Wars on the frontier may not yet be ruled out altogether, even for purely defensive purposes; though the international situation seems to be much more sane to-day than in the past. Exchange has been stabilised, though the finality of the arrangements of 1927 may be open to question. I take it, however, that the introduction of a proper gold standard is now a question of time only ; and so on this head of exchange no

substantial margin of expenditure need be provided. Opium revenue sacrifice has already been made up for; while Famine, the most considerable risk of the Indian financier, and not yet adequately insured against, may be taken to be a steadily diminishing source of danger.

Another point, connected with this aspect of public economy in a country like India, must also be mentioned at this stage. While the expenditure of the governing bodies in the country has never been reviewed radically and comprehensively as might be desired, much less has it been considered with due reference to the nature and sources of the revenue from which this expenditure is to be met. Public Finance has been considered,—whenever consideration has been devoted to it,—by divorcing aspects thereof that cannot naturally be divorced. Revenue is the positive aspect of expenditure, and *vice versa.* Expenditure, properly incurred, may add to the revenue yielding capacity of the country; and revenue scientifically derived may render expenditure most fruitful or serviceable, without proving an undue burden to the citizen. But this ideal cannot be reached, unless and until the two aspects are simulltaneously considered, in every detail of each side. To consider each side by itself is bound to give an incomplete view, injurious, as it would be unreliable. Once again, however, in India, we have never had such a simultaneous consideration of every aspect of public finance, which would entitle us to proceed in our analysis and constructive suggestions on reliable, official data. Just as the Inchcape Committee considered the field of expenditure for the Government of India alone, the Taxation Committee has reviewed the field of revenue both for the provincial and the central governments,—with, however, notable exclusions in regard to the Land Revenue, and the profits of public enterprise. But the revenue side

was impossible to consider in strict concordance with the expenditure side by this Committee; and so its findings and recommendations are even less serviceable, from our particular standpoint, than those of the Indian Retrenchment Committee. The latter had a narrower field; and surveyed that field with a narrower vision. The former had a much broader field; and it was composed of men who were expected to bring a more scientific attitude of mind than the self-confessed body of businessmen who made up the Inchcape Committe. The latter made no pretence to a thorough, scientific consideration of the task assigned to them; and they cannot, therefore, be blamed if they failed from a standpoint which they had never professed to adopt. And yet, the Report of the Taxation Committee seems to me to be even more barren, from the standpoint which particularly interests me at the moment, than that of the Retrenchment Committee.

What are the Expenditure needs, then, of the Central Indian Government in the light of such an analysis of the needs of the country, in respect of functions assigned to that body, as we have made? The total volume of this expenditure will, of course, depend on the functions assigned to the Central Government. But, for the sake of simplicity in discussion, let us assume that these functions remain substantially unaltered. There is room, in the present scope of the Indian Government's activities, for substantial retrenchment in their expenditure on national defence, as well as in the general scale of the cost of the *personnel* in all the superior ranks of the public service. The defence expenditure may be reduced to 40 crores or less per annum, without in any way affecting the security of the country from the forces of disorder at home, or of aggression from without. A saving,

of 15 to 20 crores is possible in this item alone and must be effected forthwith, if the national expenditure is to be most economically made. The possible saving from revising the scale of salaries and allowances in all the superior ranks of the public service would not result in very substantial gains for the Government of India ; though, in the Provinces, with their much larger expenditure in this behalf, the tale would be different. In the *Sixty Years of Indian Finance*, I have made a suggestion for a progressive reduction of the higher salaries and emoluments, which, if adopted, would save annually a crore of rupees. But this saving may be absorbed by the improvement to the point of a minimum of living wage to the much more numerous, and much less well-paid, ranks of the menial and subordinate services in public departments. On the whole, then, we may abandon any hope of a net substantial saving under this head. The same may be said in respect of the Interest and Sinking Fund charges of the Public Debt Service. These are contractual charges, which cannot be reduced materially without a wholesale repudiation. The provision now-a-days made by way of a Sinking Fund is the best assurance under existing conditions for that improvement in public credit, which would most effectively reduce this item in the long run. The only positive suggestion in this department, then, would be: that no further debt be incurred by any government in India, except for objects, which may reasonably be expected to pay for themselves in a prescribed time, and even leave a surplus for the State. The consequence would be that while new debt would be stopped, or would be incurred for objects and purposes which will involve no new burdens, the old debt will go on being automatically reduced, till the amount now payable by way of interest and sinking fund provision would be wholly saved.

The position of the Government of India Expenditure, on the existing basis of division of functions would, thus, be :—

Expenditure on Defence	..	Rs. 40 crores
,, ,, Interest &c.	..	,, 50 ,,
,, ,, General Administration	..	,, 20 ,,
	Total	Rs. 110 crores

The commercial services of the Post Office and the Railway may have considerable scope for retrenchment; but this had better be allowed for on the revenue side.

As compared to the present standard of 130 crores, this represents an immediate economy of about 20 crores., As and when the Debt charge is diminished, a *pro tanto* saving on that head would either mean a further fall in the volume of expenditure, to the maximum of 50 crores; or greater ability to that extent for more productive or needful spending. If the Government of India imposes upon the constituent members of the Indian Federation, by common consent of the National Assembly, additional or more extensive obligations for the better government of the people than is the case to-day ; and if, because of this, that Government is obliged to make special subventions for such purposes to the provinces as well as the States, the subventions will be derived as much from the saving thus effected, as from the surplus of revenues at the disposal of the Central Government arising out of the redistributed resources as shown below.

For the Provinces, the similar calculation of a definite standard expenditure is difficult to make in the aggregate, and far more in particular. Much will, of course, depend on the fate of the present day idea of a redistribution of the British provinces into more self-contained and homogeneous units,

which will in all probability be smaller than the present provinces, and less wealthy. Some of these, if not all, may, in consequence, need wet-nursing financially, for some time at least, by the Federal Government of India. No process of provincial reconstruction must, however, be suffered to reduce the aggregate revenue resources of the country as a whole, so that, while individual provinces might show a weaker position financially, the country as a whole must continue to show the same undiminished financial strength as at present. The problem will, in that case, be a simple question of taking from Paul something to give it to Peter, for the purpose of putting both Paul and Peter on a basis of substantial equality. If additional obligations are imposed on the provincial authorities,—*e.g.* in the shape of a compulsory system of free universal education upto a fairly respectable standard, in accordance with the demands of civilised life ; or in the shape of special provision for workmen's insurance against all the common contingencies of life, including unemployment due to the mere slackness in trade,—means will have to be found by the authority imposing these functions to facilitate their due discharge. In any case, we may fairly assume that the present standard of provincial expenditure is in urgent need of very considerable expansion, if the very irreducible minimum of civilised government and the commonest rights of human citizenship, are assured to the citizens of these provinces. If education needs an immediate increment of another 20 crores, in round terms, to assure the irreducible minimum of instruction for the citizen ; and medical, sanitation and the more material concerns of industrial development, and scientific research, are expanded in a like proportion, the provincial Budget will have to be increased, in the aggregate, and immediately, by at least 45 crores over the present standard of

90 crores, giving an aggregate of 135 crores. Against this, we may set off the possibility of saving by effecting available retrenchment and economy in the scale of salaries &c., and in the establishment charges, by at most 10 crores,allowing for the increase of the pay of the menial and subordinate staff to the prescribed standard of a decent living wage. The net increase is thus 35 crores over the present standard, or an aggregate provincial ex penditure of 125 crores immediately, with possibility of steady expansion. The latter, however, we may trust, will be provided for from a similar expansion in the revenue resources, which must also improve; particularly if, as we may legitimately assume, the entire public expenditure is laid out so scientifically as directly to add to the tax-paying ability of the citizen.

The aggregate for British India is thus 125 *plus* 110, or 235 crores, hardly more than ten crores over the present standard. The case of the Indian States is more difficult still. It is impossible to compute their needs, even in the aggregate, simply because no reliable data are available. The principal States, however, are estimated to have an aggregate expenditure of some 45 crores per annum; and if to that figure we add a proportionate figure in respect of the minor States for whom statistics even of this vague description are not available, the aggregate may be taken to be 50 crores. The review of the States finances, in the aggregate as well as severally,—with a view to detrmine the irreducible minimum of the expenditure in the States,—is even more indispensable than in the case of British India, if really satisfactory federal financing is to be achieved. In the absence of such definite data, and working on the asumption that the figure above-mentioned is sufficiently near the mark to serve as a basis for argument, we should say that all the immediate needs of the

States by way of expansion would be served by an increase of 25% in the aggregate, net. With an aggregate expenditure of 60 crores per annum, the States ought to have a standard of government, twice as good as in British India, since for one-fourth the poulation of the British provinces, they would have nearly half the expenditure of the latter. As, however, the system of administration in the States has hitherto been far more backward than in the British territories, they have a great leeway to make up ; and so their need for additional expenditure, even on this somewhat higher scale, would be incontestable. The scope of internal economy and retrenchment in the States,—particularly in respect of the unproductive and disproportionate expenditure of the Ruling Princes and their families,—is by no means inconsiderable. The single item of the military expenditure in the States that still go on incurring it admits of considerable retrenchment, on the ground that: the task of the defence of the country being centralised in the Federal Government, all the other constituents the Federation ought to be relieved of this burden in proportion. But even if it is considered to be indispensable for the States to go on incurring this expenditure, for reasons of local prestige as well as of security, the expansion in their expenditure can be easily met by subsidies from the Government of India, out of the States' fair share of the Customs &c. which we have already reviewed.

On the revenue side, similarly, it is impossible to calculate with any degree of reliability or accuracy, the possibility of expansion of the existing revenues, by their redistribution and reconstruction among the federated units and the Federation of India. The total revenue needs, however, are, in round figures, not more than 285 crores per annum, immediately, including only the net receipts from the commercial services conducted by the State.

To consider better the possibility of manipulation and improvement in the revenue resources of the Federation, let us take the existing figures for 1926-27, and estimate, as best we can, the possibility for improvement and readjustment.

Revenues in 1926-27 *of British India.*

(*N.B.*—The figures are in thousands of rupees):

Item of Revenue.	Imperial.	Provincial.
	Rs.	Rs.
Customs	47,38,11	..
Taxes on Income	15,64,96	33,32
Salt	6,69,81	..
Opium	4,33,13	..
Land Revenue	41,00	34,47,31
Excise	41,13	19,41,55
Stamps	26,69	12,92,93
Forest	23,57	5,95,26
Registration	1,57	1,44,12
Tributes	83,52	..
Scheduled Taxes	..	36,45
Total Principal Heads ..	76,23,52	74,90,96
Railways	34,07,08	2,24
Irrigation	10,25	6,69,80
Post Office	70,64	..
Interest	4,08,59	2,35,64
Civil Administration	86,05	3,65,64
Currency and Mint	4,15,51	..
Civil Works	15,79	69,21
Miscellaneous	60,01	1,91,40
Military Receipts	4,94,68	..
Provincial Contributions	5,17,12	—5,17,12
Extraordinary	60,10	1,31,47
Total ..	1,31,65,47	86,43,15

Of these, we may leave aside the Provincial Contributions and extraordinary items, as those we cannot count upon for the ordinary, normal

revenue purposes. But the remitted provincial contributions will nevertheless count on the provincial side as increased revenues, being part of their normal income, which, under the old dispensation, was paid to the Government of India. In the aggregate there would be no difference; but as for each of the partners sharing, there would be a material difference

Of the principal heads of Revenue, the distribution should, under Indian conditions, be so far changed, I think, as to assign all the proceeds of indirect taxation to the Central Federal Government, and those of the ordinary, existing direct taxation to the constituent States and Provinces. This would mean that the Customs, Salt, as well as Excise Revenue would go entirely to the Central Government *Per contra*, Taxes on Income would revert to the Provinces; and Land Revenue, Stamps, Registration, and Forests income would remain as before to the constituent States and Provinces. The Imperial Government would seem to benefit by an accession of an item worth nearly 20 crores, at the cost of an item worth 16 crores at most to-day. In reality, however, in so far as Excise is a diminishing source of revenue, with a possible risk of total extinction, the Government of India does not secure quite as much benefit as appears to be the case at first sight. On the other hand, the Provinces seem to lose a larger for a smaller source of revenue; and the increment in each province would be nothing like equal. Besides, in so far as the main source of provincial revenue,--that from land,--is, in many provinces, in urgent need for recasting, with a view to a greater liberalism in the assessment and collection of this revenue, there is a considerable danger of the Ryotwari provinces losing a substantial portion of their present income, without an adequate compensation from the substitute given to them. If the

Land Revenue and the Income Tax are assimilated, and the exemption now given to agricultural incomes is removed, it is likely that the sacrifice in the Provinces would be neither so severe, nor so permanent as might be apprehended at first sight. The deficit, however, such as it promises to be, even in the immediate years after the changes are given effect to, may be made up, either by subsidies from the Central Federal Government,—a course, not at all impracticable in view of the substantial gains that Government may make on its revenue side, as shown below; or by imposing some additional taxation by way of excise, *e.g.* on tobacco grown in the province, manufactured, and sold. For the Government of India, also, the entire income from the Income Taxes will not disappear; partly because it would be the easiest to leave the tax from all income derived from ramifying interprovincial enterprises, with seats of operations in one province and owners of the income in another, to the federal government; and partly because all incomes which now-a-days escape the Indian Income Tax must be brought within the scope of that tax, and be assigned to the Federal Government. The rate of the tax, the manner of its assessment, the mechanism for its collection, must all be prescribed by central legislation, if only to ensure that degree of uniformity, which is necessary for the success of this tax. If the Federal Government is further assigned all proceeds from additional Death Duties; and if a suitable differentiation is made between earned and unearned incomes, with a view to a sharper taxation of the latter; if, finally, the rate of progression and the maximum of tax-rate are increased, there need in reality be no deficit to the provinces. The Central Government ought also to be fully insured against the anticipated decline in the Excise Revenue from intoxicants. Direct Taxation thus reformed may be made to yield 50 crores at the lowest calculation;

out of which 30 crores may be left to the provinces, and the balance to the central Government.

There is, for all the central and local governments concerned, a further margin of expansion in the productive public works, which each of them already owns. The State Railways of the Central Government are capable of yielding a much greater surplus profit to the State than is the case to-day, partly because the Railways have so far not been conducted as economically as they might have been, and partly because it is possible to graft on to this enterprise other services which could easily bring in a surplus to the State, *e.g.* by insuring, for a consideration, the lives of railway travellers, and the property of railway customers. On goods of the total value of a thousand crores or more that the Indian Railways carry every year, and on passengers, a most moderate rate of insurance may easily add ten crores to the surplus from this asset. It is, of course, impossible to estimate exactly to-day; but it may be expected to serve the turn of the Central Government for additional revenue, if the experience of other countries is any guide in the matter. The Post Office is another great commercial institution, whose commercial possibilities, by improving the existing services and adding new ones, still lie unexplored in a very large measure. I cannot stop here to discuss these possibilities; and must refer those of you who are more keenly interested in such matters to other works on the subject of Indian Finance. Between the two of these, the Government of India might well add 20 crores a year to their revenues, by progressive increments within a space of five years from the date of commencing such a policy. Banking facilities to the public, conducted by the State, may similarly bring additional grist to the mill of the State. Its exact contribution cannot, of course, be calculated to-day; but it may be relied on to add not less

than 10 crores per annum, including interest on reserve securities. On the provincial side, the public enterprise now conducted by the provinces is limited to the productive Irrigation Works. These are not all equally productive in every province; and not capable of any considerable expansion of revenue in any province. Forests embody great possibilities for future development. But they must first cost vast sums in capital outlay to the provincial governments, before they are developed in all their possibilities. The possibility of roads, as a productive asset to the provincial governments, is as yet utterly unknown. Other enterprises may be devised by individual provinces, *e.g.* fishing for food, or for pearls, and other products by the maritime provinces; and mineral wealth by the more inland provinces; and this may also eke out the provincial budget materially.

These changes may be translated in practice as shown in the following *pro-forma* figures :—

* Skeleton statement (rough estimates only) of the Revenue in India :—

(In lakhs of rupees).

Items of Revenue.	Imperial Government. Rs.	Provincial Government. Rs.	
Customs	55,00	..	
Taxes on Income ..	10,00	20,00	
Death Duties, etc...	20,00	..	
Salt and Opium ..	8,00	..	
Excise (Intoxicants)	17,50	7,50	(Tobacco).
Land Revenue ..	40	20,00	
Stamps, Forests and Registration .	70	19,30	
Tributes	..	..	
Railways (Net surplus)	17,00	2,50	(Roads).
Civil Works ..	15	70	
Irrigation	10	6,70	
Post Office	5,00	..	
Interest	4,00	2,50	
Currency and Banking	6,00	..	
Departmental Fees	85	3,50	
Miscellaneous ..	70	1,90	
Military Receipts ..	..	..	
Total ..	1,45,40	84,60	Grand Total 2,30,00

* Cp. the following Table from the *Sixty Years of Indian Finance*, p. 388. (*N.B.*—Figures are in Crores).

REVENUES.	Rs.	EXPENDITURE.	Rs.
Land Revenue ..	20.00	Direct Demands ..	15.00
Opium	3.00	Interest on :—	
Salt	5.00	Industrial Debt ..	20.00
Stamps	15.00	Agricultural Debt	15.00
Excise (including Tobacco)	20.00	Transport Debt ..	15.00
		Unproductive Debt	20.00
Customs	55.00	Education	40.00
Income Taxes and Death Duties ..	45.00	Police	10.00
		Post Office	10.00
Forests Domain ..	10.00	Sanitation	5.00
Registration (including Marriage Fees) ..	10,00	Law and Justice ..	7.00
		Agriculture	5.00
Post Office	15.00	Miscellaneous ..	5.00
Railways (net) ..	20.00	Pensions, etc. ..	10.00
Irrigation	5.00	Transport and Communications ..	10.00
Industrial Surplus ..	10.00		
Miscellaneous Fees ..	7.00	Defence	45.00
		Industrial Development	11.00
Total ..	240.00	Total ..	240.00

As the recommendations in that work, as well as in this,

These are, it cannot be repeated too often, only tentative,—and, at that, very rough, estimates. They are based on assumptions already—explained, except that the Customs revenue is supposed to admit of sharper graduation, and therefore of better yield in that part of the tariff schedule constructed for revenue purposes only. The increment in the Post Office, Railways, and Banking enterprise, including currency, is necessarily progressive; while the item of Excise in the Imperial Government may be regarded as diminishing in the near future. Military receipts and Tributes are ruled out, the former because we take the Military or Defence Expenditure net; and the latter because we see no justification for maintaining this obsolete item in the Budget of the federal government.

The aggregate gives to the Central Federal Government at least 25 crores more than need be required by that body, if the changes suggested in its expenditure sheet are given effect to. The bulk of this revenue surplus is capable of being distributed among the provinces,—at least 20 crores to begin with, to ensure the provision of that indispensable and irreducible minimum of civic rights, which the Indian Government have so far failed to afford. The balance may make the beginning of a refund to the States, which, on the counts enumerated in a previous Lecture, they feel themselves entitled to. The aggregate refund to the States collectively,—on account of the Customs,

have run on similar lines, there is no material disparity in the statements. The statement in this Note gives the items of revenue and expenditure collectively for the Imperial as well as the Provincial Governments, while that in the text gives them separately. The Note does not allow sufficiently for the progressive nature of some of the suggested changes, which must necessarily take time to materialise to perfection, while the estimate in the text is more cautious.

Salt, Income Taxes, Currency Receipts,—not to mention Railways,—would amount to over 15 crores, on the basis of calculation favoured by the States. But that would presuppose a theory of political structure in the country, which would give undue and undesirable prominence to the separatist tendency, that we cannot do too much to scotch. As, moreover, the redrafting of the public expenditure in India would take into account the interests and requirements of the States in all matters of common national service, the States would benefit as much as the rest of India from these increased activities of the State for the benefit of the subject; and so the strongest ground for their claims to a refund would be materially weakened. The aggregate refund or subvention to the States collectively cannot exceed in the initial years at least, 5 crores. When, however, revenue resources, especially from productive state enterprise, develop fully, the claims of the States may be more liberally considered, if by that time the particularist tendency in that peculiar form has not been checked. In the progressive items of income, like that from the productive enterprise of the State, the States may be made to share indirectly by increasing the subventions payable to them on the same basis as the provinces. But the one condition of paying such subventions advantageously must never be lost sight of, *Viz.* that the payments should not be made an excuse for undermining the local autonomy of the provinces and the States in any way. The principles governing the grant of the subsidy,—which may be reversing the recent financial practice in India, but which is amply supported by the experience of other federations,—will have to be evolved in common consultation, perhaps after exhaustive and searching investigation by a committee of experts, so as to pay due attention to the conditions and requirements of

every unit in the Federation, The life of the Federal State must be considered to be one, and the several units making up that State must be regarded as the different facets of a common vital principle inspiring the entire body politic. On that basis, I anticipate no difficulty in working out all the details for financial reconstruction, in full concord with the best traditions of democratic federal governments; and there is no other way that I can see, whereby our country may attain to practical *Swaraj* and financial salvation.

I have now covered the field I had assigned to myself to survey for the purposes of this Series. I trust I have not abused your patience unduly, though I am fully conscious of having trespassed more than once on the time limit usually assigned to such Lectures. I have, likewise, to thank the Professors and Students of the Patna College, not only for the handsome hospitality they have shown to me, but also for the sympathy and understanding displayed in all quarters for the somewhat unfamiliar work I had undertaken to do. Expressions of gratitude on such occasions as these tend to be so usual, that one is apt to make a considerable discount, from the face-value of such statements, before accepting and endorsing them. I trust, however, that the short space of time in which we have come to know one another would have given you, as it has given me, a better mutual knowledge, that would make you take the sentiments I now express at the full value of the words expressing them, and hold me to be your debtor for the sympathy and hospitality shown to me during all this week.

GOOD NIGHT!

BIBLIOGRAPHICAL NOTE.

It will not be quite in keeping with the general character of these Lectures to append a long bibliography. The subject, moreover, has seldom been treated from the stand-point here adopted by classic writers on Public Finance. The following works on the theoretical aspect of the subject, as on the working of federations elsewhere in the world, together with some leading works on Indian Finance, would, it is hoped, provide sufficient basis for the earnest student to begin his studies on.

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